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No. 88——

IN THE
Supreme Court of the United States
OCTOBER TERM, 1988

NEW ENGLAND TELEPHONE AND
TELEGRAPH COMPANY, *et al.*,
Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTION PRESENTED

In early 1976, the Federal Communications Commission (FCC) prescribed a 9.5% rate-of-return for the Bell System Companies' interstate telephone service, plus a .5% "efficiency incentive." The Bell System Companies promptly filed rates designed to comply with this order. Those rates generated earnings of 9.25% in 1976, 9.59% in 1977, and 10.22% in 1978, for an overall return during those three years of 9.69%. In 1984, the FCC ordered the companies to refund their "excessive" earnings of 1978, without taking account of their earnings in 1976 and 1977. In 1985, the FCC adopted a rule applying the rate-of-return prescription/refund approach underlying its 1984 order to all carriers. A divided panel of the D.C. Circuit affirmed the FCC's 1984 refund order and another divided panel, although remanding the 1985 rule, reaffirmed the FCC's statutory authority to order refunds. A sharply divided *en banc* court with numerous recusals refused to reconsider the panels' decisions. Under these circumstances, the question presented is:

Whether the "rule against retroactive ratemaking," which is grounded in the Communications Act and similar federal regulatory statutes and was heretofore universally recognized as protecting both utilities and customers from *post hoc* rate revisions, bars federal agencies from requiring a utility to make refunds to customers on the ground that its prior earnings exceeded a specified rate of return?

PARTIES TO THE PROCEEDING

The following were parties to the proceeding in the court of appeals (those parties who have joined in this petitions are designated by an asterisk):

Petitioners below: New England Telephone and Telegraph Company,* New York Telephone Company,* Nevada Bell, Pacific Bell, South Central Bell Telephone Company, Southern Bell Telephone and Telegraph Company, American Telephone and Telegraph Company, The Mountain States Telephone and Telegraph Company,* Northwestern Bell Telephone Company* and Pacific Northwest Bell Company.*

Intervenors below: Illinois Bell Telephone Company,* Indiana Bell Telephone Company, Inc.,* Michigan Bell Telephone Company,* The Ohio Bell Telephone Company,* Wisconsin Bell, Inc.,* GTE Service Corporation,* GTE Domestic Operating Companies,* United States Telephone Association,* Telecommunications Research and Action Center, National Telephone Cooperative Association, *et al.*, Satellite Business Systems, Southwestern Bell Telephone Company, and Bell Atlantic Telephone Companies.

Respondents below: Federal Communications Commission and the United States of America.

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* The statement pursuant to Sup. Ct. Rule 28.1 is set forth in Appendix I, 167a-168a.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

OPINIONS BELOW

The opinion of the D.C. Circuit in the case here under review (hereafter the *"Refund Case"*) (Pet. App. 1a-39a) is reported at 826 F.2d 1101. The opinion of the D.C. Circuit in a closely related case (hereafter the *"Rulemaking Case"*) (Pet. App. 141a-159a) is reported at 836 F.2d 1386. The opinions accompanying the orders denying rehearing *en banc* in both the *Refund* and *Rulemaking Cases* (Pet. App. 133a-140a and 160a-166a) are not yet reported. The initial order of the Federal Communications Commission ("FCC" or "Commission") in the *Refund Case* (Pet. App. 40a-85a) is reported at 102

F.C.C. 2d 52. The FCC's orders denying reconsideration (Pet. App. 86a-120a and 121a-129a) are not reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 130a-132a) was entered on August 21, 1987. Petitions for rehearing and rehearing *en banc* were denied on November 2, 1988 (Pet. App. 133a-140a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Section 205 of the Communications Act, 47 U.S.C. § 205, provides:

> (a) Whenever, after full opportunity for hearing, upon a complaint or under an order for investigation and hearing made by the Commission on its own initiative, the Commission shall be of opinion that any charge, classification, regulation, or practice of any carrier or carriers is or will be in violation of any of the provisions of this chapter, the Commission is authorized and empowered to determine and prescribe what will be the just and reasonable charge or the maximum or minimum, or maximum and minimum, charge or charges to be thereafter observed, and what classification, regulation, or practice is or will be just, fair, and reasonable, to be thereafter followed, and to make an order that the carrier or carriers shall cease and desist from such violation to the extent that the Commission finds that the same does or will exist, and shall not thereafter publish, demand, or collect any charge other than the charge so prescribed, or in excess of the maximum or less than the minimum so prescribed as the case may be, and shall adopt the classification and shall conform to and observe the regulation or practice so prescribed.
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> (b) Any carrier, any officer, representative, or agent of a carrier, or any receiver, trustee, lessee, or

> agent of either of them, who knowingly fails or neglects to obey any order made under the provisions of this section shall forfeit to the United States the sum of $1,000 for each offense. Every distinct violation shall be a separate offense, and in case of continuing violation each day shall be deemed a separate offense.

Section 4(i) of the Communications Act, 47 U.S.C. § 154(i), provides:

> The Commission may perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions.

STATEMENT OF THE CASE

In precisely defining and limiting the FCC's authority regarding telephone company and other communications carriers' rates, the Communications Act typifies the federal statutes that equip agencies with ratemaking authority.[1] Under Section 203, 47 U.S.C. § 203, carriers must file tariffs setting forth the charges and other terms and conditions for their service; thereafter they must render service in strict compliance with those tariffs. Under Section 204(a), 47 U.S.C. § 204(a), the FCC may temporarily suspend and then investigate new tariff rates filed by a carrier; if it determines that these rates are unreasonable, the Commission may prescribe the charges to be collected in the future.[2] Under Section

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[1] Other statutes with similar ratemaking schemes are the Natural Gas Act, 15 U.S.C. § 717, *et seq.*, the Federal Power Act, 16 U.S.C. § 791, *et seq.*, and the Interstate Commerce Act, 49 U.S.C. § 10101, *et seq.*

[2] Under Section 204(a) the FCC may also order a carrier to account for revenues pending an investigation and may thereafter require the carrier to refund that portion of its increased charges that the FCC ultimately finds to be not justified. *See also*, 15 U.S.C. § 717c(e) (Natural Gas Act); 16 U.S.C. § 824d(e) (Federal Power Act); 49 U.S.C. § 10705(b) (Interstate Commerce Act).

205(a), 47 U.S.C. § 205(a), the Commission may, on its own motion or upon complaint, initiate an investigation of a carrier's existing rates; if the Commission determines that the rates are unreasonable, its only remedy is to prescribe the carrier's future charges.[3]

The FCC's First Prescription of a Rate of Return—the Nader Case. In 1971, the FCC initiated an investigation under Section 204(a) to determine the lawfulness of new tariffs filed by the American Telephone & Telegraph Company and its Bell System Companies (hereafter collectively referred to as "Bell").[4] The Commission divided its investigation into two phases, the first of which focused upon Bell's authorized rate of return,[5] while a later phase was to consider the many other issues necessary to determine the lawfulness of the Bell rates. Phase I of the proceeding was concluded in November 1972, when the FCC decided that Bell was entitled to a rate of return of 8.5%. Bell immediately filed new, higher rates designed to achieve this return, and the FCC allowed them to become effective subject to its ultimate

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[3] *See also*, 15 U.S.C. § 717d(a) (Natural Gas Act); 16 U.S.C. § 824e(a) (Federal Power Act); 49 U.S.C. § 10704(a)(1) (Interstate Commerce Act).

In addition to the ratemaking authority given to the FCC by Sections 203-205 of the Communications Act, the Commission also has authority under Sections 206-209 of the Act, 47 U.S.C. §§ 206-209, to adjudicate the lawfulness of a carrier's charges and award damages to customers if those charges are unlawful. *See*, p. 14, n.19, *infra*.

[4] *See generally, Nader* v. *FCC*, 520 F.2d 182, 187-191 (D.C. Cir. 1975), setting forth, in detail, the many steps involved in the FCC's 1971 investigation.

[5] As the FCC and the Court of Appeals made clear in the *Rulemaking Case*, the "rate of return" used by the Commission in ratemaking proceedings is the "minimum" required by the Constitution to avoid confiscation of a carrier's property. (Pet. App. 145a).

decision as to the many other undecided questions to be considered in Phase II.[6]

Bell's customers and competitors sought review of this decision in the D.C. Circuit arguing, *inter alia*, that the FCC erred in allowing Bell to raise its rates in this manner. The court of appeals disagreed. It upheld the FCC's interim prescription of a rate of return pending the completion of a rate investigation on the ground that "ratemaking is a complex and difficult task" which frequently requires "several consecutive proceedings." *Nader* v. *FCC*, 520 F.2d 182, 203-04 (D.C. Cir. 1975).[7]

The FCC's Misapplication of Nader—the Refund Case. In January 1975, Bell filed new proposed tariffs containing rates designed to generate a return above the 8.5% permitted by the Phase I decision in the then still ongoing Bell rate investigation. The FCC rejected the filing on that basis, but agreed to decide whether changes in the financial markets or in Bell's capital structure justified a higher rate of return. *In the Matter of American Telephone & Telegraph Co.*, 57 F.C.C.2d 960 (1976). On February 4, 1976, the Commission concluded that changed circumstances justified a 9.5% rate of return, with an additional .5% efficiency incentive. Accordingly, it prescribed a 9.5% rate of return, but held that Bell earnings of up to 10% or less "shall not require any

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[6] *Nader*, 520 F.2d at 190.

[7] No refund issue was before the court in *Nader*. However, *in dicta*, the court stated that the FCC's interim prescription order protected Bell from the possibility of refunds based on contentions that an 8.5% rate of return was too high and that the FCC retained full latitude to order refunds on all other lawful grounds, including the yet-to-be-decided issues in Phase II of the rate investigation pertaining to the companies' income, costs and rate base. 520 F.2d at 204-05 n.25. These types of refunds could conventionally be ordered pursuant to Section 204(a) after a general rate investigation where, as in *Nader*, the FCC had suspended carrier-initiated rates and subjected them to an accounting order. *See*, p. 3, n.2, *supra*.

downward adjustment of [Bell's] overall interstate rates. . . ." *Id.* at 973.[8]

Bell immediately filed rates based on the 9.5% return prescribed by the Commission, and the FCC allowed them to become effective. However, in 1976 those rates produced only 9.25%, about $100 million less than would have been generated had Bell achieved the 9.5% return that the FCC had prescribed and $300 million less than the maximum 10.0% permitted by the Commission.[9] Those same rates in 1977 resulted in a return of 9.59%, about $180 million less than Bell would have received had it earned 10.0%.[10] Without changing those rates, Bell in 1978 earned 10.22%—$101 million more than it would have realized had it achieved a 10.0% return.

After receiving Bell's report of its 1978 earnings, the FCC published a notice of inquiry to consider alternative regulatory responses, ranging from one that would have characterized the prescribed rate of return as a "target" to be used in designing tariffs, to another that would have treated the 1976 order as establishing a 10% ceiling on Bell earnings with refunds of earnings above the

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[8] In March 1977, the FCC terminated the general investigation that it had commenced in 1971, finding the 1971 Bell rates to be "just and reasonable, and therefore lawful, pursuant to 47 U.S.C. §§ 201-5." *In the Matter of AT&T*, 64 F.C.C.2d 1, 110 (1977), *on reconsideration*, 67 F.C.C.2d 1429 (1978), *modified*, 72 F.C.C.2d 1 (1979).

[9] Comments of AT&T in Response to Notice of Inquiry, CC Dkt. No. 79-187 (filed November 13, 1979), C.A. Jt. App. 188. ("C.A. Jt. App." refers to the Joint Appendix in the court of appeals). Bell's 1976 rates became effective on February 27, 1976. Bell earned 8.83% in 1975, *id.* at 189; assuming that it earned the same return during the first two months of 1976, its return for the last 10 months of 1976, after its new rates became effective, was 9.33%.

[10] *Id.*

ceiling.[11] It took more than five years for the Commission to decide among these alternatives.

Ultimately, on December 11, 1984, the FCC held that Bell must refund $101 million of its 1978 earnings, plus interest, by reducing rates in 1985-86 to levels below those that the companies would otherwise have been entitled to charge. Pet. App. 40a-85a.[12] In doing so, the FCC took the position that Section 205 and Section 4(i) of the Communications Act gave it authority to order a refund to enforce its 1976 prescription order whenever Bell's earnings exceeded 10.0%. The FCC refused to allow Bell any credit or offset for the $100 million of deficient 1976 earnings and treated as irrelevant the fact that the rates which Bell filed in 1976 produced a return for the 1976-1978 period of 9.69%, well within the range established by the FCC in its 1976 prescription order.[13]

Bell sought review of the FCC's order in the D.C. Circuit, challenging the FCC's authority to order refunds

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[11] *In the Matter of AT&T Earnings During 1978*, 75 F.C.C.2d 412 (1979) (C.A. Jt. App. 12-22).

[12] The refund ordered by the FCC was apportioned among AT&T and the various Bell Operating Companies ("BOCs"), which by this time had been divested from AT&T, on the basis of each company's investment in assets devoted to interstate service in 1978. *See*, Pet. App. 54a-55a & n.28. On this basis, the BOCs bore about 68.5% of the total liability for the refund.

[13] Requests for stays of the refund order were denied, FCC No. 85-573 (Oct. 30, 1985) (C.A. Jt. App. 73), and the companies filed tariffs that reduced their charges for the ensuing year. This Court has ample equitable powers to allow the BOCs to recapture this refund, should it ultimately reverse the D.C. Circuit. *See, United Gas Improvement Co.* v. *Callery Properties, Inc.*, 382 U.S. 223, 229-30 (1965); *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 347 (1956); *SEC* v. *Chenery Corp.*, 332 U.S. 194, 200-201 (1947); *Public Service Co. of N.H.* v. *FERC*, 600 F.2d 944, 961 (D.C. Cir.), *cert. denied*, 444 U.S. 990 (1979); *Tennessee Valley Mun. Gas Ass'n* v. *FPC*, 470 F.2d 446, 452-53 (D.C. Cir. 1972); *Williams* v. *Washington Metropolitan Area Transit Comm'n*, 415 F.2d 922, 941-42 & n.97 (D.C. Cir. 1968), *cert. denied*, 393 U.S. 1081 (1969).

to enforce a rate-of-return prescription order. A divided panel affirmed the refund order as a valid exercise of the FCC's authority under Sections 205 and 4(i) of the Communications Act. Pet. App. 1a-39a. *New England Tel. & Tel. Co.* v. *FCC*, 826 F.2d 1101 (D.C. Cir. 1987). The majority (Judge Mikva and District Judge Parsons) recognized that the FCC's "current regulatory scheme is asymmetric," because "carriers must refund excess earnings, but they are not compensated for shortfalls." Pet. App. 14a. However, it concluded that carriers "have no statutory entitlement to a perfectly balanced regulatory scheme; rather, they are entitled only to earn an overall reasonable return." *Id.*

Judge Buckley dissented. He seriously questioned the statutory authority of the FCC to utilize a rate-of-return prescription/refund scheme, noting that:

> "[f]or more than fifty years, the Communications Act has been understood to establish a precise, express statutory scheme governing refunds and the setting of rates. Never before has Section 4(i) been held to authorize refunds." Pet. App. 20a-21a.

For that reason he disagreed with the FCC's imposition in 1984 of a refund liability based on a 1976 prescription order that did not foreshadow such relief. *Id.* at 20a-39a.

The FCC's Extension of Its Refund Approach to All Carriers—the Rulemaking Case. During the final stages of the FCC's consideration of the refund order, it instituted a proceeding to consider a rule that would extend the approach underlying that order to all carriers. On September 30, 1985, the FCC adopted an "automatic" refund rule based solely on Sections 205(a) and 4(i), declaring that it would biennially determine a reasonable rate of return for carriers and that they would be required to refund earnings if they exceed that return, plus a small "buffer," without any setoff for prior inade-

quate earnings. Moreover, the FCC rule provided that carriers would be required to refund "excessive earnings" from one category of service during a two-year period, even if their overall earnings on interstate services were deficient.

Bell and a number of other carriers petitioned the D.C. Circuit to review this rule. A majority of the panel (again Judge Mikva, this time joined by Judge Bork) endorsed the *Refund Case*, stating that it "clearly defeats the claim that a refund scheme in conjunction with rate-of-return regulation is necessarily incompatible with the regulatory scheme embodied in the Communications Act." Pet. App. 150a. *AT&T* v. *FCC*, 836 F.2d 1386, 1392 (D.C. Cir. 1988). The court went on, however, to condemn as arbitrary and capricious the particular scheme embodied in the rule and remanded the case to allow the Commission to refashion a new rate-of-return prescription/refund mechanism.

Judge Starr concurred in the judgment, but disagreed that the FCC was authorized to promulgate rate-of-return prescription/refund rules. Pet. App. 152a-159a. In his view:

> "Congress constructed the [Communications] Act so that the Commission's remedial power is limited to prospective relief: when the Commission determines that existing rates are excessive it cannot order a refund of past payments under the revoked rate. Rather, the FCC can only correct the problem through a *prospective* prescription under section 205." *Id.* at 155a (emphasis in original).

Denial of Rehearing En Banc. Petitions for rehearing *en banc* in the *Refund Case* were filed by the Bell Companies, while the FCC filed a conditional rehearing petition in the *Rulemaking Case*. The petitions were denied

by a closely divided *en banc* court from which several members of the Circuit were recused.[14]

Judge Starr dissented (joined by Judges Williams and Buckley). He argued that the FCC's approach did "violence to well-settled, salutary doctrines, such as the bar on retroactive ratemaking and the filed rate doctrine." Pet. App. 135a, 162a. He lamented the fact that, because a number of judges did not participate, the issue of the FCC's authority could not qualify for *en banc* treatment. Under these circumstances, he described the law of the D.C. Circuit "on a pivotal statutory issue cutting across agency lines" as "distressingly unsettled." *Id.*

REASONS FOR GRANTING THE WRIT

The D.C. Circuit's decision in this case is inconsistent with more than 50 years of settled precedent in this Court, as well as the courts of appeals. By prescribing a rate of return and then requiring carriers to refund earnings above that rate, the FCC has violated the "rule against retroactive ratemaking" codified in the Communications Act, as well as other comparable federal regulatory statutes, and has thereby upset the balance between utility and customer interests established by Congress in those statutes. This Court should exercise its certiorari jurisdiction to review the decision below because it threatens the ratemaking schemes that apply to most utilities whose rates are regulated by the federal government.

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[14] Four judges (Wald, Robinson, Mikva and Edwards) voted to deny rehearing in both cases; three (Starr, Buckley and Williams) would have set both for rehearing as to the FCC's authority to order refunds; three (Ruth B. Ginsburg, Silberman and Douglas H. Ginsburg) abstained in both cases; and one (Sentelle) abstained in the *Rulemaking Case*, while voting to deny rehearing in the *Refund Case* because of "multiple recusals." Pet. App. 133a-140a and 160a-166a.

I.

The rule against retroactive ratemaking operates in a balanced manner, protecting customers from *post hoc* rate increases for those years in which a utility's earnings are deficient, but letting utilities keep earnings in years when they exceed the rate of return upon which prior rates were premised. The FCC's rate-of-return prescription/refund scheme destroys that balance between customer and utility interests.

Ratemaking involves four basic questions, all of which are essentially predictive: (1) What assets are used by the utility in providing its regulated service and thus are entitled to be included within its "rate base?" (2) What rate of return will the utility be allowed to earn on its rate base? (3) What costs in providing its service can the utility properly claim should be reimbursed by its customers? (4) What rates will allow the utility to cover its costs and earn its authorized return? [15]

For large and complex carriers, like the Bell Companies, it is impossible to predict with precision the myriad factors ultimately affecting their actual return.[16] Where actual costs exceed the estimates used in setting rates, the carrier's actual earnings may fall below the envisioned rate of return. Conversely, where the economy picks up and demand for service increases, the carrier may earn more than that rate of return. Thus, the return that a carrier in fact earns will almost never be the precise rate of return upon which its rates were initially premised.

It is uniformly recognized that, notwithstanding fluctuations in the many factors that affect return, carriers

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[15] *See*, 1 A. Priest, *Elements of Public Utility Regulation* 45 (1969).

[16] Ratemaking is an "empiric" process that "is fluid and changing." *Board of Trade* v. *United States*, 314 U.S. 534, 546 (1942).

that place into effect agency-prescribed rates are thereafter protected from refund claims by customers arguing that those rates have become unreasonably high; conversely, such carriers may not retroactively seek to obtain increased charges on the ground that the agency's prescription order has led to inadequate returns. *See, e.g., Arizona Grocery Co.* v. *Atchison, T. & S.F. Ry.*, 284 U.S. 370 (1932):

> "Specific rates prescribed for the future . . . become the legal rates. . . . If [the Interstate Commerce Commission] sets too low a rate, the carrier has no redress save a new hearing and the fixing of a more adequate rate for the future. It cannot have reparation from the shippers for a rate offered under the order upon the ground that it was unreasonably low." *Id.* at 387-88.
>
> * * * *
>
> "Where the Commission has . . . declared what is the maximum reasonable rate to be charged by a carrier, it may not at a later time . . . subject a carrier which conformed thereto to the payment of reparation measured by what the Commission now holds it should have decided in the earlier proceeding to be a reasonable rate." *Id.* at 390.[17]

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[17] The rule of *Arizona Grocery* builds upon principles established in earlier cases holding that a carrier may keep the benefits of high earnings, but conversely that it must bear the losses in years where its actual return was deficient. As this Court explained in *Board of Public Utility Comm'rs* v. *New York Telephone Co.*, 271 U.S. 23, 31-32 (1926):

> "The revenue paid by the customers for service belongs to the company. . . . If there is no return, or if the amount is less than a reasonable return, the company must bear the loss. . . . And the law does not require the company to give up for the benefit of future subscribers any part of its accumulations from past operations. Profits of the past cannot be used to sustain confiscatory rates for the future."

See also, FPC v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 590 (1942).

Arizona Grocery plainly prohibits the FCC from ordering refunds to a carrier's customers where its rates have been prescribed and intervening circumstances have pushed the carrier's earnings to levels beyond those anticipated by the Commission. Similarly, a regulatory agency may not order such general refunds where the carrier has initiated rates that have not been suspended and investigated by the agency. *See, Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 251 (1951) (describing the "filed-rate doctrine"). In both settings the courts have repeatedly reaffirmed that federal statutes like the Communications Act grant agencies only prospective ratemaking authority. *See, Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 578 (1981); *FPC* v. *Sunray DX Oil Co.*, 391 U.S. 9, 24 (1968); *Atlantic Ref. Co.* v. *Public Service Comm'n*, 360 U.S. 378, 389 (1959); *T.I.M.E., Inc.* v. *United States*, 359 U.S. 464, 468-72 (1959); *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 618 (1944).[18] This principle, which has come to be known as "the rule against retroactive ratemaking," bars " 'the Commission's retroactive substitution of an unreasonably high or low rate with a just and reasonable rate.' " *Arkansas Louisiana Gas*, 453 U.S. at 578, *quoting City of Piqua* v. *FERC*, 610 F.2d 950, 954 (D.C. Cir. 1979).[19]

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[18] *See also, TRT Telecommunications Corp.* v. *FCC*, 857 F.2d 1535, 1546, 1547 (D.C. Cir. 1988); *Dorchester Gas Producing Co.* v. *FERC*, 848 F.2d 634, 637 (5th Cir. 1988); *Gulf States Utilities Co.* v. *Alabama Power Co.*, 824 F.2d 1465, 1471, *modified*, 831 F.2d 557 (5th Cir. 1987); *City of Girard* v. *FERC*, 790 F.2d 919, 920 (D.C. Cir. 1986); *United Gas Pipe Line Co.* v. *FERC*, 657 F.2d 790, 794 (5th Cir. 1981); *Public Service Co. of N.H.* v. *FERC*, 600 F.2d at 957-58; *Indiana & Michigan Electric Co.* v. *FPC*, 502 F.2d 336, 345 (D.C. Cir.), *cert. denied*, 420 U.S. 946 (1975).

[19] There is a statutory exception to the rule against retroactive ratemaking, but it is not applicable here. As noted, p. 3, n.2, under Section 204(a) the FCC, like other agencies, may suspend and investigate newly filed rates and impose an accounting order upon a carrier for the purpose of ordering refunds if the Commission's investigation ultimately proves that the carrier's rates

The rule against retroactive ratemaking serves at least two central purposes, both of which are frustrated by the decision below. First, it creates a stable environment in which both customers and carriers can rest assured that ratemaking agencies are barred from "embroiling current and future rate regulation with [the] function of making correctives for excess or insufficiencies of rates charged in the past." [20] Second and more importantly, the rule against retroactive ratemaking balances the rights of carriers and customers by imposing equally upon both of them the risk that unanticipated changes in costs, revenues or other factors will either elevate or depress a carrier's actual return.[21]

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were too high when filed. In this case, the FCC disclaims any reliance upon Section 204(a) for at least two reasons: (1) No suspension, investigation and accounting order was entered in connection with Bell's rate of return when it filed its rates in 1976; (2) Bell's rates, which generated earnings below the 10.0% ceiling for the first two years in which they were in effect, were perfectly lawful when filed even under the FCC's own reasoning.

Also as noted, p. 4, n.3, Sections 206-209 of the Communications Act permit an individual customer to file a complaint seeking damages for a violation of the Act. However, in proceedings under these sections, the burden of proof is on the customer and the carrier is entitled to a hearing as to whether its rates were lawful at the time of the disputed charges. Moreover, relief is limited "to actual damages rather than to the full overcharge that would have been available had the FCC ordered an investigation [under Section 204(a)]." *Aeronautical Radio, Inc.* v. *FCC*, 642 F.2d 1221, 1235 n.34 (D.C. Cir. 1980), *cert. denied*, 451 U.S. 920 (1981). *See also, Southern Railway Co.* v. *Seaboard Allied Milling Corp.*, 442 U.S. 444, 454-55 (1979). In this case, the Commission has never sought to justify its refund order by relying on these provisions, which involve the exercise of the FCC's adjudicative, not its ratemaking, authority.

[20] *American Public Gas Ass'n* v. *FPC*, 567 F.2d 1016, 1057 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978). *See also, Columbia Gas Trans. Co.* v. *FERC*, 831 F.2d 1135. 1141 (D.C. Cir. 1987).

[21] This rule represents a specific application in a ratemaking context of a more general proposition, recently confirmed by this

The FCC has violated the rule against retroactive ratemaking embodied in the Communications Act, disrupting this carefully crafted balance between carrier and customer interests, and a sharply divided D.C. Circuit, left short-handed by multiple recusals, has failed to stop it. *Compare, United States* v. *SCRAP*, 412 U.S. 669, 697 (1973), where this Court reversed the D.C. Circuit for not paying heed to the Interstate Commerce Act's "careful accommodation of the [carrier and shipper] interests involved" in that statute. Instead of investigating and prescribing rates, the Commission prescribed only a rate of return. It then required the carriers to refund any earnings that they realized above that return, while denying them any opportunity to recover deficiencies in their prior earnings. In this way, the FCC has deprived carriers of the benefits implicit in the statutory scheme—*i.e.*, that they can keep earnings which exceed those expected by the FCC at the time of a prescription order—and has placed upon carriers all of the risks that intervening events will depress their earnings below those levels anticipated by the FCC.

Those risks are clearly demonstrated by the fact that, despite its best efforts in 1976 to design rates to achieve the 9.5% minimum level of earnings allowed by the FCC, Bell earned only 9.25% that year, about $100 mil-

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Court in *Bowen* v. *Georgetown University Hospital*, —— U.S. ——, 57 U.S.L.W. 4057, 4058 (Dec. 12, 1988), that:

> "a statutory grant of legislative rulemaking authority will not, as a general matter, be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by Congress in express terms. *See Brimstone R. Co.* v. *United States*, 276 U.S. 104, 122 (1928) ('The power to require readjustments for the past is drastic. It . . . ought not to be extended so as to permit unreasonably harsh action without very plain words')."

Under the Administrative Procedure Act, 5 U.S.C. § 551(4), ratemaking is a form of rulemaking. Therefore, *Bowen* and similar cases condemn any form of retroactive ratemaking that is not explicitly sanctioned by the Communications Act.

lion less than would have been produced if it had achieved a reasonable rate of return. The FCC's decision forced Bell to bear the consequences of the unforeseeable increase in costs or decrease in revenues that depressed its earnings in 1976, while at the same time forcing it to refund to customers its "excessive" 1978 earnings brought about by opposite forces operating on its costs or revenues. The Commission's action vividly illustrates the manner in which its violation of the rule against retroactive ratemaking has disturbed the balance expressed in the Communications Act between customer and carrier rights.

II.

The FCC's rate-of-return prescription/refund scheme was based entirely on Sections 205(a) and 4(i) of the Communications Act. Neither supports the agency's action.

A.

Section 205(a) on its face condemns the position taken by the FCC in this case; codifying the rule against retroactive ratemaking, it provides that if a carrier's charges are excessive the FCC's only remedy is to prescribe the "just and reasonable" charges that are "to be thereafter observed." Thus, Section 205(a) is entirely prospective and provides no basis for ordering refunds based on prior excessive earnings.

Second, as previously noted, p. 3, n.2, *supra*, Section 204(a) explicitly provides for refunds when a carrier initiates new rates and the Commission suspends and investigates them and requires the carrier to account for its charges. The fact that Congress equipped the FCC with refund authority in that context, but not under Section 205(a), clearly shows that Congress' withholding of refund authority under Section 205(a) was not inadvertent. As is shown by Judge Starr's opinion in the *Rulemaking Case*, Pet. App. 157a-158a, relevant legislative history further confirms this conclusion.

Third, had the FCC fully exercised its prescription authority in the manner contemplated by Section 205(a) and specified the rates that Bell must charge customers, under the principles of *Arizona Grocery* the Commission would have been powerless to order Bell to make refunds to its customers even if subsequent events elevated its return above levels that were just and reasonable. As Judge Starr observed in his opinion in the *Rulemaking Case*,

> "it is passing strange to allow the Commission to order refunds (and thereby undercut the Congressionally ordained values of stability and predictability) where a rate-of-return prescription is exceeded, but not where a just and reasonable charge is exceeded." Pet. App. 157a.

Finally, Section 205(b) empowers the FCC to enforce compliance with prescription orders by imposing substantial fines when a carrier "knowingly fails or neglects to obey an order made under the provisions of this section. . . ." The Commission never found in the *Refund Case* that Bell "knowingly fail[ed] or neglect[ed]" to comply with the FCC's rate-of-return prescription. Instead, the Commission takes the position, flatly inconsistent with Section 205(b), that carriers bear an absolute liability to refund monies to customers whenever their return exceeds a prescribed level, "however innocently" the carriers behave. Pet. App. 9a.

B.

Relying upon Section 4(i) of the Communications Act, 47 U.S.C. § 154(i), the court of appeals held in the *Refund Case* that the FCC had authority to create an "asymmetric" ratemaking scheme that disturbs the statutory balance between carrier and customer rights. In reading Section 4(i) as empowering the FCC to so change the ratemaking regime established by the Communica-

tions Act, the D.C. Circuit has rendered a decision that conflicts with those of this Court and other Circuits.

Section 4(i) allows the FCC to take only such action as is "not inconsistent with" the other provisions of the Communications Act and is "necessary in the execution of its functions." It does not permit the Commission to act in a manner that is neither consistent with Section 205 nor necessary to achieve the purpose of that section.

Moreover, this Court, other federal appellate courts, and the D.C. Circuit itself, when interpreting Section 4(i) and like provisions of other regulatory statutes, have held that a power asserted under such a provision must be consistent not only with the specific terms of the statute, but also with the statute's general structure and policies. For example, in *AT&T* v. *FCC*, 487 F.2d 865 (2d Cir. 1973), the Second Circuit rejected the FCC's argument that Section 4(i) of the Communications Act authorized it to require AT&T to obtain advance approval from the Commission before filing tariff revisions:

> "In enacting Sections 203-05 of the Communications Act, Congress intended a specific scheme for carrier-initiated rate revisions. A balance was achieved after a careful compromise. The Commission is not free to circumvent or ignore that balance. Nor may the Commission in effect rewrite this statutory scheme on the basis of its own conception of the equities of a particular situation." *Id.* at 880 (footnote omitted).

On similar reasoning, this Court in *FPC* v. *Texaco Inc.*, 417 U.S. 380, 394 (1974), concluded that Section 16 of the Natural Gas Act, 15 U.S.C. § 717*o*, which corresponds to Section 4(i) of the Communications Act, "does not authorize the Commission to set at naught an explicit provision of the Act." The court of appeals' broad reading of Section 4(i) as allowing the FCC to restructure the ratemaking regime established by the

Communications Act conflicts with this Court's decision in *Texaco*, the Second Circuit's decision in *AT&T* v. *FCC*, as well as many other cases.[22]

III.

The opinions of Judges Mikva and Starr, standing alone, reveal the significance of the issue presented here. In his opinion in the *Refund Case*, Judge Mikva proclaimed that an agency can change the scheme of regulation embodied in its enabling act from one in which there is a fair balance of customer and utility rights to one that is "asymmetric;" in his view, the only constraint on agency action is the constitutional limitation that utilities should have an opportunity "to earn an overall reasonable return." Pet. App. 14a.[23] By con-

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[22] *See, e.g., Murphy Oil Corp.* v. *FPC*, 431 F.2d 805, 810 (8th Cir. 1970) (Section 16 of Natural Gas Act "is not an enlargement of the specific authority granted the Commission under §§ 4, 5 and 7 of the Act"); *Hirschey* v. *FERC*, 701 F.2d 215, 218 (D.C. Cir. 1983) (to imply from Section 309 of the Federal Power Act the authority to vacate final and nonreviewable license exemptions "would make a sham of the carefully crafted license exemption regulations and render superfluous the *specific* revocation procedures set forth in [the Commission's rules]") (emphasis in original); *Turner* v. *FCC*, 514 F.2d 1354, 1355 (D.C. Cir. 1975) (affirming FCC decision that, notwithstanding Sections 4(i) and 303(r) of the Communications Act, "the authority to order reimbursement of legal expenses should not be implied 'absent specific statutory authority' ").

Cf., CAB v. *Delta Air Lines, Inc.*, 367 U.S. 316, 325 (1961), where this Court, notwithstanding the presence in the Federal Aviation Act of a supplementary-powers provision (Section 204(a), 49 U.S.C. § 1324(a)) equivalent to the Communications Act's Section 4(i), struck down an action of the CAB which was inconsistent with the Act's provisions governing certificates of public convenience and necessity, stating that "the specific instructions set out in the statute should not be modified by resort to such generalities as 'administrative flexibility' and 'implied powers.' "

[23] Judge Mikva's blurring of the distinction between constitutional and statutory limitations on an agency's ratemaking author-

trast, Judge Starr recognized in the *Rulemaking Case* that Congress had, "[i]n crafting [the] elaborate scheme" embodied in the Communications Act, Pet. App. 153a, carefully specified customer and carrier rights in the ratemaking process, and he decried the resort to formless provisions, like Section 4(i), to permit agencies to rearrange the regulatory structures established for them by Congress.

The recusal of a number of judges of the D.C. Circuit prevented that court from assembling *en banc* to reconsider the approach taken by Judge Mikva in disposing of an issue that affects virtually every industry whose rates are regulated by the federal government.[24] The "distressingly unsettled" state of the law of the D.C. Circuit (Pet. App. 135a, Starr, J., dissenting)—the court that reviews most of the ratemaking cases decided by federal agencies—fully justifies exercise by this Court of its certiorari jurisdiction.[25]

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ity is inconsistent with this Court's recent decision in *Duquesne Light Co.* v. *Barasch*, —— U.S. ——, 57 U.S.L.W. 4083, 4087 (Jan. 11, 1989). In any event, the FCC's prescription/refund scheme would over time violate even the constitutional principle that carriers are entitled to a reasonable return on their investment. *See, id.*; *FPC* v. *Hope Natural Gas Co., supra.* Inevitably, if carriers are required to return "excess" earnings above some reasonable rate of return, but are forced to absorb shortfalls in years that their earnings are deficient, they will systematically be denied an opportunity to earn a reasonable return.

[24] Rule 35(a) of the Federal Rules of Appellate Procedure provides that rehearing *en banc* will be granted only on the vote of a majority of the active members of the court of appeals, and the D.C. Circuit has interpreted that rule to require a majority "regardless of recusals or temporary absences." *Handbook of Practice & Internal Procedures*, U.S. Ct. App., D.C. Cir. § XIII.B.2, p. 68 (Aug. 1, 1987).

[25] *See, Webster* v. *Doe*, —— U.S. ——, 108 S. Ct. 2047 (1988) (certiorari granted to resolve important issue after evenly divided D.C. Circuit denied rehearing *en banc*). *See also, John Hancock Ins. Co.* v. *Bartels*, 308 U.S. 180, 181 (1939); *Maggio* v. *Zietz*, 333

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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No. 88——

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, *et al.*,
Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,
Respondents.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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APPENDIX A

UNITED STATES COURT OF APPEALS
DISTRICT OF COLUMBIA CIRCUIT

Nos. 85-1087, 85-1457, 85-1471, 85-1472

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, *et al.*,
Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION and the UNITED STATES OF AMERICA,
Respondents,

GTE SERVICE CORP., *et al.*, NATIONAL TELEPHONE COOPERATIVE ASSOCIATION, *et al.*, AMERICAN TELEPHONE & TELEGRAPH CO., AMERITECH OPERATING CO., MOUNTAIN STATES TELEPHONE & TELEGRAPH CO., *et al.*, SATELLITE BUSINESS SYSTEMS, U.S. TELEPHONE ASSOCIATION, TELECOMMUNICATION RESEARCH & ACTION CENTER, SOUTH CENTRAL BELL TELEPHONE CO., SOUTHWESTERN BELL TELEPHONE CO.,
Intervenors.

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,
Petitioner,

v.

FEDERAL COMMUNICATIONS COMMISSION and the UNITED STATES OF AMERICA,
Respondents,

U.S. TELEPHONE ASSOCIATION, GTE SERVICE CORP., *et al.*, MOUNTAIN STATES TELEPHONE & TELEGRAPH CO., *et al.*, BELL OPERATING COMPANIES, SOUTHWESTERN BELL TELEPHONE CO.,
Intervenors.

THE MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY, *et al.*,
Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION and the UNITED STATES OF AMERICA,
Respondents,

GTE SERVICE CORP., *et al.*, AMERITECH OPERATING CO., AMERICAN TELEPHONE & TELEGRAPH CO., BELL OPERATING COMPANIES, SOUTHWESTERN BELL TELEPHONE CO., *Intervenors.*

PACIFIC BELL, *et al.*,
Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION and the UNITED STATES OF AMERICA,
Respondents,

GTE SERVICE CORP., *et al.*, MOUNTAIN STATES TELEPHONE & TELEGRAPH CO., *et al.*, AMERITECH OPERATING CO., AMERICAN TELEPHONE & TELEGRAPH CO., BELL OPERATING COMPANIES, SOUTHWESTERN BELL TELEPHONE CO.,
Intervenors.

Petitions for Review of Orders of the Federal Communications Commission

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Argued Oct. 30, 1986

Decided Aug. 21, 1987

Before MIKVA and BUCKLEY, Circuit Judges, and PARSONS,* Senior District Judge.

Opinion for the Court filed by Circuit Judge MIKVA.

Dissenting opinion filed by Circuit Judge BUCKLEY.

MIKVA, Circuit Judge:

Petitioners American Telephone and Telegraph Company ("AT & T") and numerous former Bell operating telephone companies ("BOCs") seek review of orders of the Federal Communications Commission ("the Commission") requiring them to grant rate reductions. The reductions are designed to reimburse consumers for earnings enjoyed by AT & T and the BOCs in 1978 which were over and above a rate-of-return ceiling previously prescribed by the Commission. Petitioners challenge the orders on a number of grounds, the most substantial of which is that the Commission had no authority under the Communications Act to impose such a remedy. We conclude that the Commission had ample authority to order reductions to enforce its prior rate-of-return prescription, and we deny the petitions for review.

I. BACKGROUND

A. *Regulatory Structure*

The Communications Act of 1934, ch. 652, 48 Stat. 1064 (codified as amended at 47 U.S.C.) (the "Act"), provides the regulatory ratemaking scheme within which these petitions arise. Section 203 of the Act places primary responsibility for initiating rate revisions upon the carrier. 47 U.S.C. § 203. Once a carrier initiates a revision, the Commission is empowered under section 204 of the Act to suspend implementation of the proposed tariff for up to five months while it investigates the

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* Of the United States District Court for the Northern District of Illinois, sitting by designation pursuant to 28 U.S.C. § 294(d).

lawfulness of the proposed rates. 47 U.S.C. § 204. If the Commission's investigation is not completed within that time, the proposed tariff automatically goes into effect. In such a case, however, section 204 empowers the Commission to make the increases subject to an accounting and refund order: if the Commission later determines that the revisions are excessive, it may order the carrier to refund the unjustified amount to those customers who have been overcharged. *Id.*; *see Nader v. FCC*, 520 F.2d 182, 198 (D.C.Cir.1975).

Section 205 of the Act, which is of particular relevance to this dispute, governs the Commission's authority to regulate existing rates. Under section 205, the Commission can initiate an investigation into any carrier rate or practice. If the Commission determines that a carrier rate is or will be unlawful under the Act, it may prescribe the "just and reasonable charge . . . to be thereafter observed." 47 U.S.C. § 205. This power of prescription is a potent tool: once the Commission issues a prescription order under section 205, the carrier must "cease and desist from such violation . . . and shall not thereafter publish, demand, or collect any charge other than the charge so prescribed, or in excess of the maximum . . . so prescribed." *Id.*

The Commission in this case also relied on section 4(i) of the Act. That section authorizes the Commission to "perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary in the execution of its functions." 47 U.S.C. § 154(i). As we detail below, section 4(i) previously has been held to justify the use of rate-of-return prescriptions, as opposed to prescriptions of actual rates.

B. *Regulatory History*

Although it had recommended appropriate return levels as early as 1967, the Commission first began to use its

section 205 powers to prescribe a rate of return, as opposed to a prescription of actual rates for the AT & T system in 1972. The Commission decided to undertake a rate-of-return prescription because AT & T had become so huge and diverse that individual rate determinations for each service were impractical. The 1972 order fixed a rate of return of 8.5% and rejected proposed AT & T tariffs that would have provided the company with a higher return. AT & T's challenge to that order called on this court to determine whether the Commission's section 205 powers permitted the agency to prescribe rates of return as well as rates. *See Nader v. FCC*, 520 F.2d 182, 199-205 (D.C.Cir.1975). In *Nader*, we determined, as a threshold matter, that the Commission's order fixing a rate of return was indeed a prescription. We concluded that "[w]e would be shirking reality if we did not recognize that the practical effect of the Commission's . . . order was to limit prospectively AT & T's rate of return to 8.5%, and thus [the order] was a prescription under section 205." *Id.* at 201; *see also id.* at 202 (the Commission's order was intended "to have the prospective effect of a prescription, thus, limiting the utility to that return.").

We then found that the Commission's prescription of a rate of return was consonant with the agency's statutory authority under the Act. *Id.* at 203-05. Even though section 205 refers only to the Commission's power to prescribe "charges, classifications, regulations and practices," we found that prescription of a rate of return was proper under section 4(i), which gives the Commission the power to issue such orders "as may be necessary in the execution of its functions." *Id.* at 203. In holding that "the Commission lawfully prescribed a rate of return for AT & T," *id.* at 204, we noted that "the effect of the prescription is to protect AT & T from the possibility of refunds on the ground that an 8.5% rate of return was

too high, [although] the Commission retains full latitude to order refunds on all other grounds." *Id.* at 205 n. 25.

With the issue of its power to prescribe rates of return thus settled, the Commission proceeded in 1976 to set a rate of return of 9.5% for the AT & T system. *See American Tel. & Tel. Co.*, 57 F.C.C.2d 960 (1976). The Commission added to the 9.5% figure a buffer of .5% "in order to provide an incentive to increase productivity and efficiency." *Id.* at 973. In effect, while the Commission prescribed a 9.5% rate, it let AT & T know in advance that it would tolerate "a level or range of interstate earnings not to exceed 10% before it took remedial action. *Id.*

AT & T responded to the Commission's prescription by filing a tariff structure designed to produce no more than a 10% rate of return. Without making a specific finding that they were just and reasonable, the Commission permitted these rates to go into effect on March 1, 1976. In 1976 and 1977, the rates produced a rate of return under 10%. However, the same rates in 1978 resulted in a rate of return which all parties agree exceeded the prescribed 10% ceiling.

Although it took a great deal of time to do so, *see Telecommunications Research & Action Center v. FCC*, 750 F.2d 70 (D.C. Cir.1984), the Commission eventually responded to AT & T's excessive rate of return in December of 1984, when it ordered the company to reduce its rates to refund the excess earnings to consumers. *See* J.A. 23-33. In its order, the Commission rejected AT & T's argument that the 1976 prescription was meant to be not a ceiling on AT & T's rate of return but only a target for setting rate levels; the Commission observed that the plain language in the prescription order restricted AT & T to a return of not more than 10%. J.A. 27. The Commission cited to sections 205 and 4(i) of the

Act, as well as our decision in *Nader*, in justifying its authority to enforce its prescription by ordering refunds. J.A. 28. The Commission also rejected AT & T's argument that changing economic conditions had rendered the 10% rate of return unlawfully low and therefore precluded the Commission's enforcement of the rate. The Commission explained that under the Act the carrier bears primary responsibility for initiating changes in existing prescriptions; since AT & T had initiated no such revision, the 1976 prescription remained in effect in 1978. J.A. 27.

The Commission determined that AT & T had enjoyed a 10.22% rate of return in 1978. The Commission derived the 10.22% figure from AT & T's own Interstate Monthly Report ("IMR"), which AT & T had filed with the Commission in January 1979. AT & T subsequently had submitted an "FDC Report" in which the company maintained that its rate of return for 1978 had been 10.09%. In the proceeding leading up to the orders under review, AT & T urged the Commission to compute the rate reductions based on the 10.09% figure. AT & T insisted that the 10.22% figure did not adequately account for certain services and facilities provided to other common carriers, and that integrating the relatively slight earnings of those services and facilities into the computation resulted in a net rate of return of 10.09%. The Commission, however, chose to rely on the IMR, as it had for the previous 28 years in computing AT & T's rate of return. The 10.22% reflected excessive 1978 earnings for AT & T in the amount of one hundred million dollars. The Commission ordered AT & T and its former operating companies (AT & T had by this time been divested) to lower its rates by an amount sufficient to reimburse ratepayers for that amount plus interest. J.A. 26.

In two reconsideration orders, the Commission substantially reaffirmed its December 1984 order, imposing

only slight alterations not at issue here. *See* J.A. 43-80. Specifically, the Commission again concluded that it had the statutory authority to impose the refunds on AT & T and the BOCs, that its decision did not represent a reversal of longstanding policy not to impose refunds for violations of prescriptions, and that AT & T had earned a 10.22% rate of return in 1978. AT & T and ten BOCs responded with these consolidated petitions for review. The petitioners' efforts to overturn the Commission's orders are championed in whole or in part in intervenors' briefs filed by the Ameritech Operation Companies, the United States Telephone Association, and GTE, and an *amicus curiae* brief filed by the Communications Satellite Corporation.

II. Discussion

Petitioners make three basic challenges to the Commission's orders. The first, and most important, of their contentions is that the Commission has no authority under the Communications Act to impose refunds for earnings in excess of a prescribed rate of return. A second and related argument is that even if the order did violate the Act, it departed from prior policy without adequate explanation and with unfairly retroactive effect. Third, petitioners allege various infirmities in the Commission's methods of calculating the amount of the refund liability. We address each of these contentions in turn.

A. *Statutory Authority*

Petitioners' challenge to the Commission's authority to issue the orders under review reveals two points of fundamental opposition to the agency's view of its regulatory authority. First, petitioners differ with the Commission as to the effect of the 1976 prescription. They contend that the nature of their obligation was merely to try in good faith to formulate rates that would not produce an excessive return. In the Commission's view, by contrast,

the prescription imposed a maximum return that the carriers could not exceed, however innocently. Petitioners also argue that in any event the Commission has no power to impose refunds to remedy a violation of rate-of-return prescriptions. This argument as to remedy is linked to the first contention: if the prescription obliged the carriers only to design responsive rates, the Commission would be overreaching in adopting a remedy that in effect retroactively adjusts rates that appeared reasonable when implemented. We consider first the nature of the Commission's power to prescribe rates of return and then take up the related issue of the Commission's remedial reach.

Petitioners acknowledge that once the Commission prescribes a rate of return, they are required to submit rates *designed to* achieve no more than that rate. Under petitioners' view of the regulatory scheme, however, that is all they are required to do; if they err, and rates designed to achieve a lawful return turn out to generate an excess, the prescription has not been violated. Petitioners' argument, in short, is that the Commission may prescribe constraints only on carriers' subjective efforts, not on future events. We see no reason to adopt this narrow reading of "prescription," especially when it is opposed by a more reasonable interpretation by the Commission. *See Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 843, 104 S.Ct. 2778, 2782, 81 L.Ed.2d 694 (1984). The Commission's chief concern in issuing prescriptions is protecting just and reasonable rates, not policing carriers' states of mind. The idea of a prescription under section 205 is that the agency has proclaimed that a certain situation—here a return in excess of 10%—is unlawful and *shall not occur*. Certainly carriers cannot intentionally try to violate an outstanding prescription, but that does not mean that they may achieve through inadvertence what they are forbidden from doing by design.

A central defect in petitioners' argument is a failure to recognize the import of our prior decision in *Nader* approving the Commission's authority to prescribe rates of return. *Nader* established that the Commission may determine what *rate of return* must be thereafter observed in the same way it may set a just and reasonable *rate* to be thereafter observed. We expressly recognize as much when we wrote that the Commission's order had "the prospective effect of a prescription, thus *limiting the utility to that return.*" *Nader, supra,* 520 F.2d at 202 (emphasis added). Here, the Commission has exercised its legal prerogative to prescribe a rate of return, rather than a rate. The teaching of *Nader* is that such a prescription is no less binding. If the order setting the maximum rate of return was a valid section 205 prescription, as it clearly was after *Nader*, it had "the force of a statute. . . . The carrier . . . is bound to conform." *Arizona Grocery v. Atchison Ry.*, 284 U.S. 370, 52 S.Ct. 183, 76 L.Ed. 348 (1931). *See also American Telephone & Telegraph Co. v. FCC*, 487 F.2d 865, 874 (2d Cir. 1973) (carriers are compelled to adhere to prescriptions by Commission).

Having established that the Commission reasonably determined that AT & T's 1978 earnings violated the outstanding prescription, we turn to the question of remedy. Petitioners insist that no section of the Act empowers the Commission to grant refunds for a violation of a prescription. Petitioners point out that section 204 is the only provision in the Act to expressly mention "refunds," and it applies only to Commission action following suspension of new or revised rates; the order under review corrected rates that already had been in effect for two years. Section 205, petitioners observe, is forward-looking: the Commission uses it to prescribe charges and practices "to be thereafter observed." In petitioners' view, by contrast, the Commission's order was a classic example of retroactive ratemaking, which is forbidden

under a plethora of case law interpreting sections 204 and 205 and similar provisions in analogous regulatory schemes. Finally, petitioners argue that the Commission cannot cure its lack of authority by reliance on section 4(i), because that provision authorizes only such orders as are "not inconsistent with this Act," and retroactive refunds are inconsistent with the Act.

The petitioners buttress their textual arguments with an observation that the prohibition against retroactive ratemaking is designed to achieve an overall regulatory balance between the interests of consumers, who need protection from unreasonably high rates, and those of carriers, who need assurance of a reasonable rate of return. Under a prospective ratemaking scheme, carriers are precluded from recouping shortfalls during lean years, but they are compensated by being permitted to retain excess earnings from unexpectedly profitable years. This balance, petitioners argue, is destroyed if the Commission can order refunds to enforce a ceiling on a carriers' return without also guaranteeing the carriers some minimum reasonable return.

In addressing petitioners' concerns, we note at the outset that although petitioners and the Commission both refer to the rate reductions as a "refund," the order does not impose a refund in the classic sense of restitution to an overcharged party. Here the reductions will accrue to the benefit of a different customer base from the base that contributed to AT & T's excessive earnings. The Commission's order therefore is more precisely considered a prospective rate adjustment to compensate for past surpluses. *See* J.A. 26. This case does not, however, turn on the arguably overfine semantic distinction between a refund and a prospective adjustment: even allowing for argument's sake that the Commission imposed a refund, the order was well within the agency's statutory authority.

As petitioners observe, section 204 is the only provision of the Act explicitly to mention refunds, and it does not apply to the circumstances of this case. The Commission, however, relied on another section of the Act—section 4(i)—to impose rate reduction in the amount of AT & T's excessive 1978 earnings. That provision empowers the agency to perform any act "not inconsistent with this Act, as may be necessary in the execution of its functions." We find this wide-ranging source of authority adequately supports the Commission's remedial action. In a strictly technical sense, the Commission's choice of remedy was absolutely necessary; without the reductions, the carriers in fact would not be limited to a return of 10% and the prescription would be violated. More generally, the Commission enjoys significant discretion to choose among a range of reasonable remedies, including refunds. *See Las Cruces TV Cable v. FCC*, 645 F.2d 1041, 1047 (D.D. Cir. 1981). The Commission does not have to show that it selected the only conceivably appropriate remedy in order to invoke its 4(i) powers. *See North American Telecommunications Ass'n v. FCC*, 772 F.2d 1282, 1292 (7th Cir.1985) (section 4(i) is a "necessary and proper clause" empowering the Commission to "deal with the unforeseen . . . to the extent necessary to regulate effectively those matters already within the boundaries"). Although, as petitioners point out, there are other corrective measures the Commission might have chosen, the measure it adopted in this case was appropriate and reasonable. As we said recently in another case approving of an agency's refund order, "[t]he question eventually reduces to one of judgment, informed by the policy of the statute that Congress has seen fit to enact. We find the agency's judgment . . . to be fully consistent with the Commission's broad mandate from the Article I branch to assure that all rates are just and reasonable." *Southern California Edison Co. v. FERC*, 805 F.2d 1068, 1072 (D.C.Cir.1986).

Petitioners nevertheless insist that a refund remedy is inconsistent with the Act, and therefore an inappropriate exercise of power under section 4(i), because it amounts to retroactive ratemaking. This argument again overlooks the force of our decision in *Nader* and the Commission's subsequent 1976 rate-of-return prescription. There was not retroactive ratemaking here, because the carriers' obligations were set prospectively in 1976, when the Commission forbade AT & T from earning more than 10%. The 1984 order under review merely recognized that the prior prescription had been violated and imposed a remedy for that violation. As the Commission explained, the refund order is a "dispassionate remedy for a violation in fact of an earnings ceiling. The carriers are being required merely to give up what they never should have collected in light of the rate of return prescription." FCC Br. 25 n. 31. This case is thus no different from one in which the Commission prescribed actual rates and the carrier, either intentionally or inadvertently, collected higher charges. Although no carrier has yet been so brazen, there can be little doubt under such circumstances but that the Commission would be well within its authority in forcing the carrier to disgorge the unlawful excess. *Cf. United States v. Corrick*, 298 U.S. 435, 56 S.Ct. 829, 80 L.Ed. 1263 (1936) (Commission can reject rate *filings* in excess of prescribed rates). The Commission has no more engaged in retroactive ratemaking here just because it is acting to enforce a rate-of-return prescription rather than a rate prescription.

Nor does the Commission order foster an impermissible imbalance between the interests of carriers and those of consumers. First, the Commission's 1976 prescription did provide a measure of protection for the carriers. As we noted in *Nader*, "the effect of the prescription is to protect AT & T from the possibility of refunds on the ground that an 8.5% rate of return was too high."

520 F.2d at 205 n. 25. Thus, had the cost of capital plunged in 1977, so that AT & T's return in that year of 9.59% was far above the reasonable minimum necessary to attract continued investment, the Commission nevertheless would not have been able to order a refund; rather, it would have had to initiate a new Section 205 proceeding and issue a new rate-of-return prescription, which would have had prospective force only.

It is true that the current regulatory scheme is asymmetric on another level. Since the Commission has so far declined to set minimum guaranteed rates of return for the carriers (although it has not foreclosed the possibility of doing so in the future), carriers must refund excess earnings, but they are not compensated for shortfalls. The carriers, however, have no statutory entitlement to a perfectly balanced regulatory scheme; rather, they are entitled only to earn an overall reasonable return. The Commission has concluded that a guaranteed minimum annual return is not essential to protect that right. That conclusion is a reasonable one. Under the Act, the carriers have the opportunity and responsibility to file rates that provide an adequate return. In this sense they are unlike consumers, who rely predominantly on the Commission to protect their right to just and reasonable rates. Moreover, the Commission supplements its rate-of-return prescriptions with a buffer, in this case amounting to .5%. This added increment makes it easier for the carriers to design charges that provide a rate of return in the vicinity of the prescribed ceiling. This scheme, in fact, more than adequately protected the carriers' interests in relation to the 1976 rate-of-return prescription at issue. During the five-year period in which the prescription was in effect, AT & T earned less than the prescribed ceiling of 9.5% in only one year, 1976, when it earned 9.25%. Overall, its average earnings during that period were 9.69%, well *above* the prescribed limit. In three of the five years, the carrier's rates were

designed precisely enough to produce a return above the ceiling but not so far above as to trigger a Commission remedy. Finally, the carriers can always initiate a request to increase their rates when the current tariff appears likely to result in a shortfall. Thus, the current system appears to provide ample protection for the carriers' interests without any guaranteed minimum rate of return. Should this state of affairs not hold in the future, the Commission and the courts can address the situation at that time.

In sum, the Commission was justified in finding that AT & T's excessive earnings in 1978 violated the agency's outstanding rate-of-return prescription. Having made that finding, the Commission properly exercised its authority under section 4(i) to remedy the violation by ordering rate reductions in the amount of AT & T's excessive earnings in 1978.

B. *Retroactive Application of a Newly-Announced Policy*

Several petitioners argue that even if the Commission's order did not violate the Act, it represented an abrupt reversal of prior Commission policy which could not lawfully be applied to parties who relied on the previous state of affairs. As AT & T sees it, for example, the Commission previously had followed a "target/trigger" policy, under which rate-of-return prescriptions served as targets for carrier tariffs, and excessive earnings triggered prospective relief in the form of rate adjustments. AT & T argues that it is being unfairly subjected to newly-adopted regulatory standards to which it has not had an opportunity to conform its behavior.

In large part, this claim relies on the same premise as the argument that the prescription obliged the carriers only to design rates not to exceed the Commission's ceiling. To the extent it does, we reject it for the same reasons. Once the Commission prescribed a maximum

rate of return of 9.5% with a .5% buffer, it was not reasonable for the carriers to think that the agency had an affirmative policy of permitting carriers who earned above 10% to retain the unlawful excess. It is true that the Commission had not put the carriers on specific notice that it would respond to unlawfully high returns by ordering refunds. Importantly, however, the Commission had not had occasion to do so; never before had a carrier exceeded a rate-of-return prescription.

The dissent contends that carriers twice before—in 1967 and 1968—exceeded the prescribed rate of return. Dissent at 4, 9-10. This contention is a cornerstone of the dissent's argument that the enforcement scheme adopted in this case represented a radical change in policy. The dissent overlooks the vital point that the Commission first prescribed a rate of return in 1972. Although it incorporated a rate-of-return recommendation, the 1967 order was not a rate-of-return prescription, and thus the portion of that order the dissent cites, *see* dissent at 4, is immaterial. The whole point behind our decision today, and our previous holding in *Nader*, is that the ratemaking regime changed in 1972 when the Commission began to use its section 205 powers to prescribe rates of return. That action represented a new approach to rate regulation, and its legitimacy was precisely what the fight was about in *Nader*.

Given that no carrier had ever exceeded a prescribed rate of return and that the Commission had never foreclosed the remedy it imposed in this case, the most petitioners can claim is that the order under review instituted a new policy for a new situation. This action is something very different from a departure from a clear prior policy. We recently recognized the distinction in rejecting a very similar claim that an agency refund order was a departure from prior precedent. Petitioner in that case contended that the Federal Energy Regulatory Commission retroactively applied a new policy when

it ordered a refund of excessive earnings. *See Southern California Edison Co. v. FERC*, 805 F.2d 1068 (D.C. Cir.1986). The court noted, "no agency precedent expressly addresses this precise issue. . . . We are in new territory here." *Id.* at 1071. Confronted with a novel set of circumstances, as we are in this case, the court rejected petitioner's claim that the Commission had departed from prior policy.

Finally, even if the enforcement order instituted a departure from a previous clearly articulated policy, petitioners would have no right to have the "new" policy not apply to them. Generally speaking, an agency may be prevented from applying a new policy for one of two reasons (in addition to the standard constraints that apply to any agency decision). First, a departure from prior policy cannot stand when the agency fails to explain the reason for the change. *See Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C.Cir. 1970), *cert. denied*, 403 U.S. 923, 91 S.Ct. 2229, 29 L.Ed. 2d 701 (1971). Second, under certain circumstances an agency may be prevented from applying a new policy retroactively to parties who detrimentally relied on the previous policy. *See RKO General v. FCC*, 670 F.2d 215, 223 (D.C.Cir.1981), *cert. denied*, 456 U.S. 927, 102 S.Ct. 1974, 72 L.Ed.2d 442 (1982). Petitioners can avail themselves of neither of these doctrines. As we detailed above, the Commission amply explained the source and need for its authority to remedy violations of its prescriptions by imposing refunds. This explanation fulfilled the Commission's responsibilities under *Greater Boston*. As for the retroactivity claim, petitioners have made no showing whatsoever of detrimental reliance. Indeed, it is difficult to imagine how they might make such a showing. Petitioners have insisted, as they must, that they made every effort to comply with the prescription by designing rates that would produce earnings of less than 10%. Presumably they would have behaved no differently had they clearly understood that excessive

earnings might trigger a refund order. Thus, there is no evidence that petitioners relied to their detriment on their understanding of the Commission's prior policy. In sum, even had petitioners demonstrated, which they have not, that the Commission's order departed from prior policy, they would have no equitable claim to shield them from application of the order to them.

The dissent posits that AT & T relied on an enforcement scheme that precluded refunds by not filing for rate increases and by not having an opportunity *in 1978* to convince the agency that its earnings were reasonable under then-prevailing economic conditions. Dissent at 13-15. But AT & T had every incentive and opportunity to file for an increase if it believed that the outstanding rate-of-return prescription was inadequate. It is irrational to surmise that the carrier would have declined to try to maximize its allowable profits in 1979 because it believed it would be able to retain its windfall of 1978. As for its opportunity to protest the decisions, AT & T has offered a fierce challenge now, so no remedy has been assessed without the carrier's having had a full opportunity to air all its claims. We thus can perceive no possibility of detrimental reliance in this case.

C. *Computation of the Refund*

Three final arguments address the Commission's actual computation of petitioners' liability. First, petitioners claim that the Commission should have calculated the carriers' rate of return over the entire period during which the rates at issue were in effect, rather than isolating AT & T's excessive earnings for 1978. The rates were in effect from 1976 to 1980, during which they produced an overall rate of return of 9.69%. The Commission admittedly gave only a cursory explanation for its decision to enforce the prescription on an annualized basis. It reasoned in a footnote that it adopted a

calendar-year measure because carriers' revenues, expenses, and income tax liabilities are typically evaluated on a fiscal year basis, and AT & T's own fiscal year coincided with the calendar year. J.A. 25-26 n. 12. This explanation, while brief, is sensible enough, especially since the Commission was enforcing a prescription of an annual rate of return. Moreover, prescriptions usually remain in effect for an indefinite period. Under petitioners' preferred scheme, the Commission would never be able to find and remedy a violation until it opted to issue a new prescription, because the agency would not know until then over what period the prior prescription was in force. In short, while the Commission perhaps might have opted for a different interval of measurement, *cf. Authorized Rates of Return*, 50 Fed.Reg. 41350 (October 10, 1985) (two-year interval), its choice of the traditional calendar year certainly was not unreasoned.

Petitioners also urge that the FCC failed to meet its burden of adducing substantial evidence for its determining that AT & T earned a 10.22% return in 1978. The Commission, however, amply supported its decision to rely on the 10.22% figure in the IMR that AT & T filed in January 1979 rather than the 10.09% figure in the subsequent FDC Report. First, the Commission pointed out that the agency and the industry had relied on the IMR return figures for 28 years, whereas the FDC Reports first had been submitted in 1977. J.A. 25. Second, certain of the computations in AT & T's FDC Report relied on extrapolations from the month of June 1978, even though, in the Commission's opinion, AT & T had not shown that the June figures were perfectly representative of the year's earnings. *Id.* Thus, the Commission adduced substantial evidence for both its confidence in the traditional IMR and its lack of confidence in the FDC Report that AT & T urged the Commission to employ. We therefore have no cause to doubt the reasonableness of the Commission's reliance on the 10.22% figure.

Finally, intervenor United States Telephone Association argues that the Commission should not be able to require petitioners to pay interest on the excess earnings for the entire period between January 1, 1979, and the date on which carriers file tariffs to implement the refund. USTA believes the Commission abused its discretion in ordering full interest payments in light of the Commission's own prolonged delay in responding to the violation. While this court does not condone the Commission's delinquency in resolving this matter, *see Telecommunications Research & Action Center v. FCC*, 750 F.2d 70 (D.C.Cir.1984), we perceive no inequity in requiring petitioners to pay full interest on earnings they had no right to retain in the first place.

III. Conclusion

The order under review was a straightforward and legitimate means for the Commission to enforce its 1976 rate-of-return prescription. In ordering a rate reduction in the amount of petitioners' excessive earnings, the Commission acted within its authority under the Communications Act and did not depart from prior policy. Finally, the Commission's method of computing the excess was reasonable and supported by substantial evidence. For these reasons, the petitions for review are denied.

It is so ordered.

BUCKLEY, Circuit Judge, dissenting:

Section 4(i) of the Communications Act is sufficiently broad and the principles of deference to agency decision-making sufficiently strong that, in the judgment of the majority, the FCC has statutory authority to enforce a prescribed maximum rate of return. Correct or not, the majority overstates the case. For more than fifty years, the Communications Act has been understood to establish

a precise, express statutory scheme governing refunds and the setting of rates. Never before has section 4(i) been held to authorize refunds. While there is always a time for firsts, I think it must be admitted that, even if lawful, the FCC here operates at the feather edge of its statutory authority.

This is not the occasion to decide the statutory issue. Without notice, the FCC altered its fundamental policy basing rates of return exclusively on *current* market conditions, and instead ordered a reduction in future rates based on *past* surplus. The *Refund Order* should be set aside because it contradicts the system of rate-making previously articulated and applied by the FCC.

I. Retroactivity Doctrine

In this circuit, as we have so recently confirmed, the test presented in *Retail, Wholesale & Dep't Union v. NLRB*, 466 F.2d 380, 390 (D.C.Cir.1972), "provides the framework for evaluating retroactive application of rules announced in agency adjudications." *Clark-Cowlitz Joint Operating Agency v. FERC*, 826 F.2d 1074 at 1081 (D.C.Cir. 1987) (en banc). Five "non-exhaustive" factors are set forth therein to distinguish between legitimate retroactive application of policy and those instances when an agency must proceed prospectively:

> (1) whether the particular case is one of first impression, (2) whether the new rule represents an abrupt departure from well established practice or merely attempts to fill a void in an unsettled area of law, (3) the extent to which the party against whom the new rule is applied relied on the former rule, (4) the degree of the burden which a retroactive order imposes on a party, and (5) the statutory interest in applying a new rule despite the reliance of a party on the old standard.

Retail, Wholesale, 466 F.2d at 390.

Taking the test in reverse order, I summarize my objection to the 1984 *Refund Order:* (1) Unlike the typical case in which an agency announces a rule through an adjudication, the FCC has formally and expressly admitted that the 1984 refund order "was not intended to establish a rule for all future proceedings. . . ." Return Interstate Services of AT & T Communications and Exchange Telephone Carriers, 50 Fed. Reg. 33,786, 33,788 (1985) (proposed Aug. 21, 1985). Instead, the FCC subsequently engaged in formal rulemaking to announce a policy of automatic refunds under specified circumstances. Authorized Rates of Return for Interstate Services of AT & T and Exchange Telephone Carriers, 50 Fed. Reg. 41,350 (1985) (final rule); Return Interstate Services of AT & T Communications and Exchange Telephone Carriers, 51 Fed.Reg. 1,795 (1986) (to be codified at 47 C.F.R. Part 65). Hence the retroactive application of the policy in the present case advances *no statutory purpose;* (2) The *Refund Order* imposes a $101 million penalty on AT & T plus interest for rates filed in 1976 and *never changed* until 1980. This is a burden by any standard. *See NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 295, 94 S.Ct. 1757, 1772, 40 L.Ed.2d 134 (1974) (prospective application favored when "fines or damages" are assessed and agency imposes new liability "for past actions which were taken in good-faith reliance on [agency] pronouncements."); (3) AT & T relied on the settled statutory scheme, confirmed in countless cases, that refunds, to be lawful, can only arise by operation of section 204 of the Communications Act. Furthermore, this court finds that were it not for section 4(i), the FCC order would be conclusively and without question unlawful. *See* Maj. at 1107, 1109; *see also MCI Telecommunications Corp. v. FCC*, 765 F.2d 1186, 1195 (D.C.Cir.1985) ("In enacting Sections 203-05 of the Communications Act, Congress intended a specific scheme for carrier initiated rate revisions. A balance was achieved after careful compromise. The

Commission is not free to circumvent or ignore that balance. Nor may the Commission in effect rewrite this statutory scheme on the basis of its own conception of the equities of a particular situation.") (quoting *American Telephone and Telegraph Co. v. FCC*, 487 F.2d 865, 880 (2d Cir.1973)); *Sea Robin Pipeline Co. v. FERC*, 795 F.2d 182, 189 n. 7 (D.C. Cir. 1986) (The Commission "may not order a retroactive refund based on a post hoc determination of the illegality of a filed rate's prescription."); (4) The FCC cannot and does not cite a single sentence from among hundreds of pages of its regulatory decisions detailing the policy upheld today. Rarely are departures from established policy as abrupt; (5) The majority states that "the Commission first prescribed a rate of return in 1972. Although it incorporated a rate-of-return recommendation, *the 1967 order was not a rate-of-return prescription*, and thus the portions of that order the dissent cites . . . are immaterial." Maj. at 1109 (emphasis added). Yet the FCC in its own rulemaking expressly hold to the contrary:

> This Commission established a *prescribed* rate of return for the interstate telecommunications services of [AT & T *in 1967*]. That *prescription* was revised in 1972, 1976, and 1981.

50 Fed.Reg. at 33,786 (1985) (footnotes omitted); *see also* 57 F.C.C.2d 960, 960 (1976) ("This proceeding represents the third time [1967, 1972 & 1976] the Commission has considered the fair rate of return of [AT & T]. . . ."). As a matter of logic, it is untenable to argue that remedying an excess rate of return represents a case of "first impression." This is a core function of any rate regulator. As a matter of fact, the FCC twice before was confronted by AT & T rates in excess of the prsescribed return. *See infra* at 1115-16.

It ultimately took the FCC six years to reach the conclusion that it (a) had the authority and (b) had

given AT & T lawful notice that returns earned in excess of the prescribed rate of return would be subject to future disgorgement. The majority says this power came into being in 1972. The FCC nowhere in its brief or on the record makes this argument. Indeed, the alteration in the FCC position is dazzling. In 1967, the FCC said "the policies we are establishing on the basis of the record of this proceeding require no drastic change in any of the standards heretofore applied and represent no new or essentially different approach by this Commismission to the regulation of respondents' interstate rates and earnings." 9 F.C.C.2d 30, 116 (1967). In its brief in the instant case, the agency said "[t]he fundamental flaw in the carrier parties' arguments in this case is that they either fail or refuse to recognize that the 1976 prescription order altered the normal pattern of carrier initiated rates under the Communications Act." Brief for Respondents at 17. At oral argument, counsel withdrew this statement. In 1987, the FCC states that it first announced the refund policy in 1984, or perhaps as early as 1979 when it issued a notice calling for comments on the subject. Brief for Respondents at 47-48, 48 n. 62, *American Telephone and Telegraph Co. v. FCC*, Nos. 85-1778, *et al.* (argued before D.C.Cir. May 21, 1987).

Fortunately, an administrative record exists to sort out which of these various arguments were actually set down on paper to guide the conduct of the industry the FCC is charged with regulating.

II. The Record

The FCC in 1984 ordered prospective rate reductions to compensate consumers for revenues earned by AT & T in 1978 based on tariff rates filed in 1976. The majority correctly describes this remedy as a policy of "prospective rate adjustment to compensate for past surpluses." Maj. at 1107. The majority incorrectly describes the

remedy as a new policy meeting a novel set of circumstances.

FCC policy governing rate-of-return regulation is contained in the administrative rulings pertaining to changes in tariffs for AT & T in 1967, 1969, 1972, and 1976. 9 F.C.C.2d 30 (1967); 21 F.C.C.2d 654 (1969); 38 F.C.C.2d 213 (1972); 57 F.C.C.2d 960 (1976). As I read these decisions, the FCC policy to remedy excessive tariffs consists of the exercise of agency authority at three successive stages: (a) pre-filing establishment of target revenues, (b) post-filing accounting pursuant to section 204 of the Act, 47 U.S.C. § 204, and (c) prospective rate adjustment, up or down, as demanded by the current economic forces in the marketplace. 47 U.S.C. § 205. The coordinated exercise of the agency authority in the first two stages in large measure eliminates the likelihood of overcharges. The option to reset future rates based on then-current conditions provides the vehicle to insure that rates continue to be appropriate over time. As this schema assures adequate protection against excessive charges, the FCC has not been faced by a novel threat. Furthermore, FCC decisions amply document these propositions.

In 1967, the FCC adopted a new method for regulating telephone rates. Instead of working from a reconstruction of each cost component incurred by AT & T, a technical and time-consuming nightmare, the FCC settled on a top-down approach based on rate of return. The required rate of return, also known as the cost of capital, is that rate "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital," balanced against the public interest in just and reasonable rates. 9 F.C.C.2d at 53 (quoting the Supreme Court's "landmark" case, *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603, 64 S.Ct. 281, 288, 88 L.Ed.2d 333 (1944)).

Conceptually, the cost of capital is divided into two components: the cost of debt, which is the interest rate enterprises must offer to attract secured funds; and the cost of equity, which is the rate of return investors must be offered to compensate them for the risk of investing in a company's stock. Because investors have numerous alternative investment prospects, the cost of capital approach to ratemaking necessarily focuses on the prospective return demanded by investors for investments of comparable risk. Thus, AT & T's cost of capital will change as necessary to reflect marketplace reassessments of these alternatives. If the rate of return earned by AT & T is set too low, it will not be able to attract either the debt or equity capital necessary to serve current consumers and meet future increases in demand. If set too high, the public interest suffers. *See, e.g.*, 9 F.C.C.2d at 52.

Rate regulation thus shifted in 1967 to a two-step process. The FCC would fix the target *rate of return*, and the carrier would set *tariff rates* designed to earn this rate of return. In either system, whether before or after 1967, there is the risk of error. In the first, *historical* costs can be misestimated and long delays and expense incurred in gathering accurate data. In the second, the FCC has recognized, and therefore so must we, that there is an inherent imprecision to measuring the *prospective* and *changing* rate of return demanded in the marketplace and a further imprecision in then requiring the carrier to set tariff rates that will produce the exact level of revenues which, after expenses have been deducted and the rate base fixed, will produce the anticipated return. *See. e.g.*, 9 F.C.C.2d at 51-88; 38 F.C.C.2d at 248-51. The so-called "novel circumstance" of a surplus rate of return is in fact a central feature of rate-of-return regulation.

Notwithstanding these differences in the approach to setting tariff rates, only the means of regulation changed

in 1967, not the basic policy. As noted, the FCC put this point beyond doubt:

> [T]he policies we are establishing on the basis of the record of this proceeding require no drastic change in any of the standards heretofore applied and represent no new or essentially different approach by this Commission to the regulation of respondents' interstate rates and earnings. On the contrary, the record and our decision confirm the regulatory standards we have generally applied over the years. Thus, prior to 1964, we permitted the respondents to maintain a level of interstate earnings within the range of 7 to 7.5 percent. When the level of earnings tended to exceed this range, we were successful, under our program of continuing surveillance, in negotiating corrective rate adjustments.

9 F.C.C.2d at 116.

The decision also affirmed that "corrective rate adjustments" would continue to be the mechanism employed to adjust for prior year excesses:

> As, and when, the going level of respondents' interstate earnings approaches either the upper or lower limits of this [7 to 7.5 percent] range, we will promptly consider what further action may be required *in light of then current conditions.* This is not to be construed to mean that any future level of earnings which exceeds 7.5 percent or falls below 7 percent will warrant immediate action *looking toward rate adjustments.* Whether or not remedial action will be required will depend upon *all the relevant circumstances obtaining at the time.*

Id. (emphases added).

When read in context, and in light of subsequent decisions, it is evident that "remedial action" contemplated the filing of revised tariff schedules designed to reduce or

increase future rates in accordance with the rate of return appropriate to circumstances at that time. The cost of capital approach can make no sense otherwise. Investors lending funds or buying equity always focus on present alternative investments, not prior circumstances.

In 1970, AT & T filed a proposal to increase interstate charges on message telephone service by "some $760 million." 38 F.C.C.2d at 215. AT & T estimated the new charges would yield a rate of return approximating 9.5 percent, the rate required by current conditions according to AT & T. In the 1972 proceedings, the FCC specified "a range of 8.5-9.0% as the range of reasonableness for the earnings of Bell on its interstate operations at the tariff rates that we are allowing Bell to file herein." *Id.* at 245. This is the prospective rate adjustment system in action. Only after evaluating operating results and revenue requirements did the FCC translate the increase in *rate of return* into a permissible *tariff rate* increase designed to produce $145 million in *incremental revenue*. *Id.* at 248-51. In the decision, the FCC reiterates that adjustments in the system come through prospective adjustments in tariff filings. *See id.* at 226-27.

Last, we reach the 1976 round of increases at issue in this case. AT & T, as usual, initiated the process in 1975 with a proposed $717 million rate increase. The FCC, exercising its prospective powers to control rates, determined the increase would exceed the rate of return then in place, and denied the proposal. 51 F.C.C.2d 619, 626-27 (1975). In other words, the policy functioned in 1976 exactly as designed—it prevented an increase in rates the FCC concluded to be unwarranted by then current conditions as measured by the rate of return.

The filing, however, prompted the FCC to investigate and update the rate of return applicable in 1976 from 8.5-9.0 percent to 9.5 percent, plus .5 percent as an efficiency incentive. 57 F.C.C.2d 960, 972-73 (1976). Once

again, in accordance with its established practice, the FCC ordered a *prospective* adjustment in the target increase for revenues. Moreover, by suspending the 1976 tariff filing for one day, the FCC triggered its statutory authority to control rates *retroactively* pursuant to section 204 of the Act, which states in pertinent part:

> [U]pon completion of the hearing and decision [the FCC] may by further orders require the interested carrier or carriers to refund, with interest, to the persons in whose benefit such amounts were paid, such portion of such charge for a new service or increased charges as by its decision shall be found not justified.

47 U.S.C. § 204(a) (1982). Although the agency did not see fit to pursue the section 204 remedy in this case, the essential point in terms of the regulatory regime is that the agency is empowered by the statute to conduct an accounting of actual results and, after a hearing, order a refund if necessary to reimburse consumers who had paid excessive charges.

III. Application To Retroactivity

This survey of the relevant FCC decisions compels the conclusion that the FCC's 1984 refund order abruptly reversed its prior policy by basing prospective tariff rates on prior returns in excess of the target levels, instead of on market conditions. Until 1984, the FCC's regulation of AT & T's rates was based *exclusively* on a forward-looking asessment of economic conditions. After 1984, the FCC order holds that rates may be reduced to compensate for past experience. The majority neatly encapsulates this abrupt switch by describing the new refund policy as a "*prospective rate adjustment* to compensate for *past surpluses.*" Maj. at 1107 (emphasis added).

A. *Novel Circumstance*

The majority seeks to justify the refund policy as a licit response to novel circumstances. In the first instance, this premise of novelty stretches the facts. In 1967, the FCC established a rate of return in the range of 7 to 7.5 percent. Based on this rate, the FCC calculated that AT & T's rates then in place were excessive. The remedy ordered was to reduce future rates to produce a $120 million reduction in revenues. At the new rate level, AT & T would earn the rate of return required by then current conditions. It was never suggested that the return should be lowered by $120 million to reflect current conditions, and then *further* reduced to collect the past overage. *See* 9 F.C.C.2d at 116.

Likewise, the agency in 1969 determined that actual charges in 1967 exceeded the allowed rate of return. 21 F.C.C.2d at 655. Again, the FCC neither ordered nor contemplated refunds. Rather, it expressed the familiar policy that "when there were departures from this range, [it would] consider the matter in light of conditions obtaining at that time." *Id.* The FCC thereupon reviewed the excess earnings on the basis of "changes which have taken place *since 1967* in the economic, financial, and other conditions that affect AT & T's revenue requirements and its ability to attract new capital"; and concluded that earnings exceeding the 1967 rate of return "[were] not unreasonable." *Id.* (emphasis added). AT & T was not required to reduce its filed tariffs.

The rate-of-return method of regulation was new in 1967, and, according to the majority, the rate-of-return prescription did not fix a maximum cap on the allowable return until 1972. This claim of a major sea-change in the 1972 proceeding is contradicted in the record, *see supra* at 1114-15, disavowed by the FCC, Brief for Repondents at 19 ("The [1976] rate of return prescription enforced in this case, like every other such prescription

the FCC has made, was implemented . . . with prospective, binding effect." (footnote omitted)), and unsupported by the *Nader* decision. *See* 50 Fed. Reg. at 33,786 n.1 ("The *Nader* opinion interpreted prior FCC decisions [back to 1967] as prescribing a rate of return for AT & T. . . ." . In any event, in terms of the assertion of novelty, these are distinctions without a difference. The FCC even in the pre-1967 regime used rates of return to evaluate the revenues allowed after costs. Moreover, the regime between 1967 and 1972 prescribed rates and hence presented the precise issue whether the increment over the targeted rate of return should be retained. Pursuant to the majority's logic, the FCC had the authority to order prospective rate adjustments as the enforcement remedy. The fundamental fact is that the agency twice before explicitly faced the problem of actual charges in excess of the announced range.

Second, common sense rebuts the majority's contention. It cannot be argued that the FCC simply failed to anticipate the essential issue of rate regulation, namely, what steps the agency should take to ensure compliance with its rate-of-return orders. In a system of carrier-initiated rates, it is unreasonable to suppose that the agency established the rate-of-return framework without giving a single thought to the prospect of what would happen if the filed tariffs produce a return in excess of the allowed minimum.

Finally, the FCC concedes, as it must, that not a single sentence in any report suggested that prospective rate adjustments might be ordered to compensate for past surplus. The omission would be almost inexplicable in a system of rate regulation that inherently can produce errors resulting in overshooting or undershooting the targeted rate of return. The FCC's three coordinate powers, as summarized below, explain the silence that the majority inaccurately construes to be evidence of a novel circumstance.

As part of the process setting the rate of return, the FCC approves or disapproves specific requests for target increases in tariff *revenues*. The revenues analysis is conducted to confirm that AT & T's probable earnings will fall within the range of the targeted rate of return. The agency's advance control over tariff rates minimizes the risk that AT & T will generate unauthorized revenues. The power to call for an accounting and order a refund allows the agency to remedy excessive returns that occur after the fact. Finally, if, as here, rates already approved subsequently produce higher than anticipated returns, the FCC can respond by analyzing present conditions to determine if the higher return is appropriate. If not, the Commission can order the carrier to file reduced tariffs targeted to meet the lower rate of return required by current circumstances.

Thus, in the present case, the FCC observed that the tariffs produced a return of 9.25 percent in 1976, confirming that the target limitation on increased revenues operated as anticipated. Hence there was no need to continue the section 204 process. In 1977, the tariffs produced a 9.59 percent return. Only in 1978 did the unchanged tariffs produce the .22 percent surplus.

It has taken the agency six years to come to the conclusion that its policy necessarily allows it to reduce future rates to remedy the situation. Based on the policy in effect when AT & T filed its tariffs, however, the FCC should have determined whether the conditions in 1978 and thereafter warranted a prospective reduction in rates. The relevant circumstances for analysis would have included the fact that (1) in an inherently imperfect regime, the excess amounted to less than one-fourth of one percent; (2) the 1976 tariff rates produced a return below 10 percent in every year other than 1978; (3) the rate of return for the entire period 1976 to 1980 averaged 9.69 percent; (4) the governing rate of return was implemented in 1976 based on economic con-

ditions obtaining in 1975; and (5) the relevant period for analyzing prospective rates, if the FCC had acted in timely fashion, would have been in 1979 or soon thereafter.

Whatever the outcome of this analysis, the fundamental point is clear. The FCC would have asked whether the overage signaled a need to reset tariff rates based on current conditions. The 1984 order confirms at a minimum that the rate of return established in 1976 continued to apply in 1978. Therefore, had AT & T in fact lowered rates in 1979 in response to the .22 percent excess in 1978, they would have realized a shortfall below even the allowed 10 percent rate of return (i.e., at the unchanged rates, the 1979 annual rate of return was 9.90 percent).

In sum, the FCC cannot cite a single passage in its regulatory decisions forecasting the refund policy announced in 1984. *See* Brief for Respondents at 22-26. The record documents two prior instances in which actual rates exceeded the target rate of return. Most important, the 1984 order—reducing future rates based on past surplus—contradicts the central premise of the FCC's state-of-return regulation and a forward-looking assessment of capital needs, instead of an historically based estimation of actual costs. In these circumstances, the FCC violated the well-established prohibition against retroactive application of a newly announced policy. *See Boston Edison Co. v. FPC*, 557 F.2d 845, 849 (D.C.Cir.), *cert. denied sub nom. Town of Norwood, Mass. v. Boston Edison Co.*, 434 U.S. 956, 98 S.Ct. 482, 54 L.Ed.2d 314 (1977); *FERC v. Triton Oil and Gas Corp.*, 750 F.2d 113, 116 (D.D.Cir.1984).

B. *Reliance*

The prohibition applies with special force when, as here, the party subject to the change has relied to its

detriment on the prior policy. Whereas the majority is unable to find any such reliance, I believe the reliance is self-evident. Prior to today's ruling, AT & T had every reason to believe that section 204 provided the only statutory mechanism for ordering a retroactive refund. The FCC concedes that this section does not apply here. Therefore, the only other provision that could arguably provide such authority, section 4(i) aside,[1] is the section 205 authority to set "just and reasonable [rates] . . . to be *thereafter* observed," 47 U.S.C. § 205(a) (emphasis added); *cf.* the regulatory analog in section 206 of the Federal Power Act, 16 U.S.C. § 824e(a), and section 5 of the Natural Gas Act, 15 U.S.C. § 717d(a).

By long-established principle, these three parallel statutory provisions "bar[] utility refunds for past excessive rates, or the Commission's retroactive substitution of an unreasonably high or low rate with a just and reasonable rate." *City of Piqua, Ohio v. FERC*, 610 F.2d 950, 954 (D.C.Cir.1979); *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 578, 101 S.Ct. 2925, 2931, 69 L.Ed.2d 856 (1981); *Indiana & Michigan Elec. Co. v. FPC*, 502 F.2d 336, 345 (D.C.Cir.1974), *cert. denied*, 420 U.S. 946, 95 S.Ct. 1326, 43 L.Ed.2d 424 (1975). While the majority finds that section 4(i) could support the particular remedy ordered here in the future, it is evident that prior to this ruling AT & T could reasonably have believed that sections 204 and 205, and the analogs in the electric and gas industry, contained the relevant statutory framework. As the FCC concedes, *see* AT & T Earnings on Interstate and Foreign Services During 1978, 48 Fed.Reg. 49,502, 49,507 (1984), and the panel holds, maj. at 14, this framework provides no authority for the 1984 refund order.

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[1] "The Commission may perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions." 47 U.S.C. § 154(i) (1982).

The majority believes AT & T should have foreseen the true novelty here, namely, the location of refund power in the section 4(i) authorization to perform such acts "as may be necessary in the execution of its function." 47 U.S.C. § 154(i). This first use of section 4(i) to authorize the 1984 refund does not void the FCC's construction of the statute. *Bankamerica Corp. v. United States*, 462 U.S. 122, 131, 103 S.Ct. 2266, 2272, 76 L.Ed. 2d 456 (1983) ("[a]uthority actually granted by Congress . . . cannot evaporate through lack of administrative exercise." (quoting *FTC v. Bunte Bros., Inc.*, 312 U.S. 349, 352, 61 S.Ct. 580, 582, 85 L.Ed. 881 (1941))). It does mean, however, that persons subject to enforcement proceedings can reasonably rely "on what was universally perceived as plain statutory language," *id.* at 133, 103 S.Ct. at 2273, or, as here, the plain statutory scheme. *See National Classification Comm. v. United States*, 746 F.2d 886 (D.C.Cir.1984) (agency cannot retroactively expose carriers to antitrust liability for reasonable reliance on a settled prior construction of an agreement.

Other factors independent demonstrate AT & T's reliance. Absent notice of the refund policy, the carrier went five years without a change in its tariff even though it could have increased its revenues in every year except 1978 without exceeding the 10 percent rate of return limit. The increased revenues would have more than offset the $101 million rate reduction ordered here. Moreover, although the agency in 1984 held that conditions in 1978 fell "within the correlative range of economic and financial market conditions," considered in 1976, 49 Fed. Reg. at 49,506 n.34, a quick perusal of the FCC opinions fixing the appropriate rate of return in a given period indicates the subject admits to less than scientific certainty. For example, the decisions document the multiple assumptions used to compile this deceptively simple rate-of-return figure and the multiple underlying debates

among economists over the proper measurement of the cost of debt and equity. *See, e.g.*, 9 F.C.C.2d at 72-86; 38 F.C.C.2d at 226-46; 57 F.C.C.2d at 962-72.

In this context, the FCC's post-hoc determination in 1984 that 1976 economic conditions still prevailed in 1978 does not mean the agency would have necessarily rejected a .22 percent increase in the allowable rate of return if vigorously pressed and documented at the time by AT & T. With such large sums of money at stake, I believe the majority is unduly formalistic when it asserts as fact that AT & T would not have behaved differently even with explicit knowledge that a .22 percent overshoot in its calculated rate of return would produce a $101 million refund order.

C. *Inherent Remedy*

A final justification relied upon by the FCC, *see* Brief for Respondents at 23, and the majority, maj. at 1109, is that the rate-of-return prescription inherently encompasses the remedy of setting a rate of return appropriate to say 1985, but then reducing that rate by a fixed sum (here $101 million plus $77 million in interest) to adjust for past surplus. FCC practice has been otherwise. FCC decisions describe a contrary system. No other regulators have seen fit to allow this system. Indeed, the FCC only began using the word "prescription" in 1973, in a discussion to which it attached no special significance, six years after adopting a policy that "represent[s] no new or essentially different approach to rate regulation. 9 F.C.C.2d at 116. *See* 42 F.C.C.2d 293, 300 (1973); 51 F.C.C.2d at 625 n. 12. To the extent the word has application here, it is to signify that the rate of return prescribes the allowable rate of return. This court said no more in *Nader v. FCC*, 520 F.2d 182 (D.C.Cir.1975). Now the FCC claims long after the fact that a prescriptive rate-setting regime silently conveys the additional prospect of an enforcement policy reducing prospective

rates to remedy past surplus. In these circumstances and in light of the FCC's insistence that rates relate exclusively to current conditions, I believe the Supreme Court has pronounced decisively The 1984 enforcement scheme "is too unprecedented a departure from the conventions of ratemaking to rest on mere inference." *Transcontinental & Western Air, Inc. v. CAB*, 336 U.S. 601, 607, 69 S.Ct. 756, 759, 93 L.Ed. 911 (1949).

D. *The Rulemaking Order*

The posture of this case would be substantially altered if the FCC were arguing its right to engage in rulemaking in an adjudicatory setting. Yet here we have the anomalous circumstance that the refund order directed at AT & T was expressly a single party adjudication. *See supra* at 1112. The subsequent decision to engage in prospective rulemaking conclusively establishes that the FCC has no statutory interest in the outcome of this particular case. *Cf. Triton Oil*, 750 F.2d at 116 ("The Commission may not abuse its discretion by arbitrarily choosing to disregard its own established rules and procedures in a single, specific case."). In the context of *Retail, Wholesale*, the substantive rationale for allowing retroactive rulemaking is sharply diminished.

Moreover, pursuant to the actual rules adopted, *AT & T would most likely not be liable for a "refund" in the instant case.* Specifically, the Commission, in its preliminary rulemaking, recognized the "inability of carriers 'to target their earnings with precision' as a result of 'unpredictable factors.' *The Commission recognized that 'disallowing any earnings 'peaks,' while ignoring the 'valleys,' would tend to induce a systematic bias that would cause a carrier to fall short of its targeted rate of return over the long run.'*" Brief for Respondents, Nos. 85-1778, *et al.* at 11 (citations to record omitted) (emphasis added).

The final rules establish several specific provisions to deal with the inherent fluctuation in return, i.e., the precise issue of this case. *See id.* at 31-34. Significantly, the measuring period for the return is two years, not one. AT & T earned 9.59 percent in 1977 and 10.22 in 1978, which produces a two-year average return of 9.91 percent. Moreover, the two-year provision allows for "mid-course corrections, thereby lessening the possibility that the enforcement mechanism would have to be invoked." *Id* at 13 (citations to record omitted). AT & T, of course, was given no such opportunity to make corrections in the present case. Indeed, it is startling that under the new rules, AT & T is expressly allowed to file increases if actual earnings are below the prescribed return during the first year. *Id.* at 33. Had AT & T been allowed the benefit of this procedure, it could have raised rates in 1976 (9.25 percent actual), 1977 (9.59 percent), 1979 (9.90 percent), and 1980 (9.90 percent) and still been below the allowable ten percent ceiling. With perfect targeting, AT & T would have earned an additional 1.36 percent, less the .22 percent surplus in 1978 for a net gain of 1.16 percent. If a .22 percent overcharge resulted in a $101 million refund order, AT & T actually could have charged approximately an additional *half-billion dollars* during this period without violating the established, lawful rate of return.

IV. Conclusion

The FCC has the statutory authority to insure that actual rates filed are likely to fall within the required range (by targeting the allowable revenue increment pursuant to section 205), and that the rates in fact do fall wthin the range (via a section 204 accounting). Over time the FCC can force prospective adjustment in rates by lowering or raising the allowed rate of return, as required by current economic conditions. Notwithstanding this comprehensive program, the majority credits the

FCC with a policy that cannot be found in the record. The opinion further ignores the carrier's reliance upon the statutory refund scheme as it existed in 1978, and rejects outright the prospect that hundred million dollar refund orders would sharpen the carrier's interest to earn all revenues to which it was entitled. Finally, the majority ignores the implications of the FCC's subsequent decision to engage in formal rulemaking. Application of well-established retroactivity doctrine requires that the 1984 *Refund Order* be set aside. I respectfully dissent.

APPENDIX B

FCC 84-567

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

CC Docket No. 79-187

IN THE MATTER OF

AT&T EARNINGS ON INTERSTATE AND
FOREIGN SERVICES DURING 1978

DECISION

Adopted: November 21, 1984;

Released: December 11, 1984

BY THE COMMISSION:

1. This proceeding was initiated as a result of information that indicated that tariffs incorporating compensation to local exchange carriers, interexchange carriers, and AT&T, would result in an earned rate of return for 1978 that would exceed the level authorized by the Commission.[1] At issue is whether the authorized rate of re-

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[1] During 1978 AT&T filed monthly reports of interstate earnings that showed earnings ratios in excess of those that had been prescribed in Docket No. 20376, 57 FCC 2d 960 (1976). On December 20, 1978, the General Services Administration wrote to the Acting Chief of the Common Carriere Bureau with respect to AT&T's interstate earnings. On July 20, 1979, the National Citizens Committee for Broadcasting, the Consumer Federation of America, and the Missouri Public Interest Research Group filed a "Petition for Enforcement of Accounting Order" which raised questions concerning AT&T's 1978 interstate earnings. Our action in this proceeding also addresses that petition.

turn for 1978 was exceeded, and if so, the remedial action that the Commission should take. We conclude that the level of interstate revenues that was received by AT&T and the Bell System Companies (hereinafter collectively referred to as "AT&T", unless the context indicates otherwise) during 1978 exceeded the authorized level by $101,000,000. We also establish a remedy by providing for reductions to prospective rates. In a forthcoming order, we will address the 1978 compensation that was received by non-AT&T/BOC carriers that was derived from interstate tariffs that were filed by AT&T.[2]

I. BACKGROUND

2. On January 19, 1976, the Commission voted to prescribe 9.5 percent as the rate of return for AT&T's interstate and foreign services. The Commission also stated that earnings equivalent to an additional 0.5 percent return on AT&T's interstate rate base would be allowed as an incentive for increased productivity and efficiency. A written decision to this effect was released on February 5, 1976,[3] that stated that the Commission would "not require any downward adjustment of AT&T's overall interstate rates provided its overall rate of return does not exceed 10 percent." AT&T filed tariff revisions on January 29, 1976 that were represented as having been designed to produce the prescribed 9.5 percent rate of return. The Commission suspended the revised rates for one day and subjected those rates to an accounting order.

3. With the increased rates in effect for only part of the year, AT&T reported an overall interstate rate of return of 9.25 percent for 1976. During 1977, AT&T's measurement of its earned rate of return increased to

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[2] *See* paras. 17, 19, and 25, *infra.*

[3] *AT&T Rate of Return,* Docket No. 20376, 57 FCC 2d 960, 973 (1976).

9.59 percent. AT&T's Interstate Monthly Reports ("IMR 1") for the first nine months of 1978 showed a cumulative annual rate of return of 10.42 percent. This prompted the Common Carrier Bureau to initiate an internal review of AT&T's earnings. On December 20, 1978, the Acting Chief of the Common Carrier Bureau formally requested information from AT&T.[4] In response to the Bureau Chief's letter, AT&T stated that its 1978 rate of return was 10.02 percent when calculated in accordance with the accounting changes concerning plant under construction that had been adopted in Phase II of Docket No. 19129.[5] It also stated that changes in economic conditions since the 1976 prescription justified an increased earnings level.[6]

4. AT&T's IMR 1 dated January 22, 1978 for calendar year 1978 showed a 10.22 percent rate of return on AT&T's interstate and foreign services.[7] The Acting

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[4] Letter to William R. Stump, American Telephone and Telegraph Company, from the Acting Chief, Common Carrier Bureau, December 20, 1979.

[5] *Phase II Final Decision and Order in Docket No. 19129*, 64 FCC 2d 1 (1977). *See Memorandum Opinion and Order In the Matter of American Telephone and Telegraph Co.*, 72 FCC 2d 1 (1979). At the time of the Bureau Chief's letter, AT&T had a petition before the Commission that subsequently was approved at a public meeting on December 21, 1978. The effect of granting AT&T's request was to increase the measurement of AT&T's earned rate of return to 10.22 percent. A more extensive discussion of the treatment of interest on plant during construtions, and its relationship to the measurement of AT&T's 1978 interstate earnings, is contained in Appendix A.

[6] Letter to Acting Chief, Common Carrier Bureau, from William R. Stump, Assistant Vice President, AT&T, January 19, 1979.

[7] The revenue required to produce an after tax rate of return of 10.0 percent for 1978 is $101.0 million less than the revenues shown on the IMR 1. Letter to Glen DeChabert, Common Carrier Bureau, from T.E. Lawrence, AT&T, October 26, 1979. AT&T Comments at para. 64. This dollar measurement has not been con-

Chief of the Common Carrier Bureau subsequently asked AT&T to explain the difference between the 10.02 percent figure cited in its letter of January 19, 1979 and the 10.22 percent figure shown on the IMR 1 which was dated January 22, 1979.[8] AT&T stated that the 10.02 percent figure for 1978 had been calculated in accordance with accounting rules for interest during construction that actually were not scheduled to become effective until January 1, 1979. AT&T further stated that it had used this measure of rate of return because it appeared to be a better indicator of future earnings levels than the unadjusted figure due to the fact that those accounting changes would tend to lower the measurement of the earned rate of return somewhat in future years.[9]

5. On September 18, 1979, the Commission adopted a Notice of Inquiry in this proceeding to examine the policy and earnings measurement issues that had arisen from AT&T's 1978 interstate operations. We requested comments on five issues: (1) Is review of AT&T's earnings on a calendar year basis appropriate in determining whether AT&T has complied with a rate of return prescription? (2) If a calendar year assessment is not appropriate, what interval should be used? (3) What is the correct measurement of AT&T's earned rate of return during 1978? (4) Has AT&T exceeded its prescribed rate of return, and if so, by what dollar amount? (5) What remedial action should the Commission take if AT&T's earned rate of return has exceeded the prescribed level? [10]

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tested by any of the parties to this proceding, and there is no question of fact incident thereto.

[8] Letter to William R. Stump, Assistant Vice President, AT&T, from Chief, Common Carrier Bureau, April 20, 1979.

[9] Letter to Chief, Common Carrier Bureau, from William R. Stump, Assistant Vice President, AT&T, May 3, 1979.

[10] *Common Carrier-Interstate and Foreign Earnings* (CC Docket No. 79-187), 75 FCC 2d 412 (1979).

6. Comments in response to those issues were filed by AT&T, the United States Independent Telephone Association (USITA), the United States Office of Consumer Affairs (USOCA), the General Services Administration (GSA), and the Massachusetts Public Interest Research Group (Massachusetts PIRG). Joint Comments were filed by the National Citizens Committee for Broadcasting, the Consumer Federation of America, the Missouri Public Interest Research Group, and the California Department of Consumer Affairs, (hereinafter collectively referred to as "NCCB"). AT&T opposed refunding any revenues that resulted in earnings in excess of 10.0 percent.

7. AT&T argued, *inter alia*, that the Commission did not have authority to order refunds of 1978 revenues. AT&T also contended that if the Commission had legal authority to order refunds, refunds were not warranted as a matter of discretion given AT&T's earnings history and then existing conditions in the financial markets. In addition, AT&T stated that its 1978 rate of return for all interstate services was not the 10.22 percent shown for 1978 on the IMR 1 but rather 10.09 percent because the 1978 IMR 1 reflected only the revenues, expenses, and investment that were associated with services provided at uniform nation-wide rates.[11] USITA also opposed any refund of AT&T's 1978 revenues, arguing that the Commission only has authority to prescribe actual rates, not a rate of return. In addition, USITA contended that the reasonableness of a given rate of return varies with changing economic and financial conditions.

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[11] A further reduction of 20 basis points (to 9.89 percent) was viewed by AT&T as being preferable to the 10.09 percent figure because the 9.89 percent measurement reflected "full implementation of the Commission's Phase II decision in Docket No. 19129." AT&T Comments at 41.

8. GSA supported refunding those revenues that caused AT&T's 1978 earnings to exceed a 10.0 percent rate of return. USOCA also supported refunds after having noted that the Commission's 1976 prescription Decision had placed AT&T on notice that 10.0 percent was the maximum allowable rate of return. Both GSA and USOCA argued that 10.22 percent was the correct figure for AT&T's 1978 earned rate of return. NCCB also supported refunds, but stated that the amount of the overage should be determined through evidentiary hearings. The Massachusetts PIRG filed a letter suggesting that AT&T's 1978 earnings in excess of 10.0 percent be used to establish a consumer action group to monitor AT&T.

9. AT&T, GSA, USOCA, and NCCB filed reply comments. AT&T argued that GSA, USOCA, and NCCB had falied to discuss the central issue in the case, erroneously assuming that the 10.0 percent figure constituted a ceiling for AT&T's rate of return despite changing economic conditions. Responding to this contention, GSA, USOCA, and NCCB argued that a rate of return prescription remains binding until changed by the Commission after a full hearing.[12]

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[12] AT&T also argued that a time period other than a calendar year should be used for assessing compliance with a rate of return prescription. In its opposition the USOCA referred to *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, a frequently cited decision that refers to the annual return that the Hope Natural Gas Co. was to achieve. *Id.* at 605. USOCA also observed that to use any measure other than the calendar year would ignore established regulatory standards. USITA stated that the exact earned ("*ex post*") rate of return of a common carrier can only be ascertained at the end of the carrier's fiscal year because it is only "at the end of the fiscal year [that] actual expenses can be subtracted from actual revenue and the result divided by the actual rate base for the year." We agree with USITA to the extent that the fiscal year of the carrier should control, as contrasted with the calendar year. The revenues, expenses, and assets of common carriers are typically subject to independent audit on a fiscal year basis, with

II. DISCUSSION

A. Assessment of Measurements of AT&T's 1978 Interstate Rate of Return

10. Including its comments in this proceeding, AT&T has provided five earned rate of return figures for 1978. The Interstate Monthly Report No. 1 ("IMR 1"), that AT&T filed with this Commission as its statement of earnings on interstate and foreign operations, reported that AT&T's earned rate of return for the calendar year ending December 31, 1978, was 10.22 percent. On June 29, 1979, AT&T submitted a "1978 Annual FDC Report" that stated that AT&T's 1978 earned rate of return on its interstate and foreign services was 10.1 percent. On November 13, 1979, AT&T filed comments stating that the 10.1 percent was really 10.09 percent.[13] The 10.02 percent measurement was supplied by AT&T on January 19, 1979, in a letter from Mr. William R. Stump to the then Acting Chief of the Common Carrier Bureau which Mr. Stump further clarified by a letter to the Chief of the Common Carrier Bureau dated May 3, 1979.

11. The five different figures that AT&T provided are based upon three essentially separate concepts. The IMR

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income tax liabilities (and filings) being based upon data that are collected during each tax payer's fiscal year. Further, the Securities and Exchange Commission's annual corporate reporting requirements (including annual reports to shareholders) are based upon the fiscal year, with the consequence that the adoption of the fiscal year for assessments of AT&T's earned rate of return would assist investors, the public, and governmental entities in reviewing AT&T's operating results on a consistent basis. Accordingly, since AT&T's 1978 fiscal year was coincident with the calendar year, we conclude that we will confine our analysis to those issues that are raised by earnings that were achieved during AT&T's fiscal year ending December 31, 1978.

[13] In the second footnote on page 43 of AT&T's comments, AT&T stated: "[t]he 10.1 percent was a rounding of a 10.09 percent, so that the excess is only 9 basis points."

1 stated that the earned rate of return was 10.22 percent. AT&T's 1978 FDC 7 Report, which was based upon data for the month of June, 1978, stated that the earned rate of return was 10.09 percent (or 10.1 percent). AT&T also contended that the preceding measurements should be reduced by twenty basis points (0.20 percent) to reflect the Commission's decisions in Phase II of Docket No. 19129. We reject this later adjustment of twenty basis points for reasons that have been expressed in our decisions in other proceedings.[14]

12. We thus turn to the adjustments that were made to the 10.22 percent reported in the December, 1978, IMR 1 to arrive at the 10.09 percent that AT&T submitted in its "1978 Annual FDC Report" as its earned rate of return for 1978. By transmittal letter dated June 29, 1979, AT&T filed a "1978 Annual FDC Report." That report, which relied upon data for the *month* of June, 1978, purported to show the rate of return that AT&T had earned during the 1978 *calendar year* on each of its interstate services. Volume 2 of that report developed a "recast" of the IMR 1 that revised AT&T's December, 1978, IMR 1 to show an earned rate of return of 10.09 percent on AT&T's interstate services. The "recast" contained interstate investment, expenses, and revenues that had purportedly not been included in the prior IMR 1 reports that AT&T had supplied to this Commission. Specifically, AT&T stated that the IMR 1 had not included investment, revenues, or expenses that were incident to the provision of interstate services at "non-uniform rates."[15] Several aspects of

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[14] At this point it is sufficient to note that we have already ruled upon this matter. *See Memorandum Opinion and Order In the Matter of The American Telephone and Telegraph Company*, 72 FCC 2d 1 (1979), and the discussion contained in Appendix A, *infra*.

[15] In its "1978 Annual FDC Report", AT&T described "services provided at non-uniform rates" as being the use of its facilities

AT&T's approach require that we not accord to the "1978 Annual FDC Report" adjustments the same weight that we attach to the figures that were contained in the December, 1978 IMR 1. For example, if "recasting" were required, actual data for the 1978 calendar year should have been employed for "recasting" rather than data that were selected for the month of June.[16] Second, no data have been presented that credibly establish that June, 1978, is a month that accurately represents the investment and/or expenses that were associated with the provision of facilities to the OCCs.[17] In this regard we concur in USITA's assessment that the measurement of excess interstate revenues for the fiscal year of a carrier requires *actual* interstate investment, expenses, and revenues for the entire fiscal year.

13. More important, however, is the fact that *this Commission has consistently relied upon the Interstate*

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pursuant to BSOC Tariffs Nos. 3 & 4, Western Union Contracts Nos. 1 & 2, and the use of its facilities by other common carriers. In its comments in this proceeding, AT&T stated that the 10.22 percent measurement contained in the December, 1978, IMR 1 has "[e]xcluded, *for example*, . . . revenues, expenses and investment associated with interstate facilities provided to other common carriers, foreign exchange channels between contiguous exchanges and less than fourteen miles in length, and link facilities for air-ground and coastal harbor service, and CATV channel service." (emphasis added)

[16] Presumably data for each of the twelve months in 1978 were available to AT&T during the Spring of 1979, given the fact that AT&T's IMR 1 for the month of December, 1978, states that it was issued on January 22, 1979.

[17] Additional issues arise with respect to the treatment of the adjustments that were made for facilities incident to the provision of services under BSOC Tariff Nos. 3 & 4 and Western Union Contracts Nos. 1 & 2. The Western Union Contracts Nos. 1 & 2 terminated on September 30, 1978, which would suggest that adjustments would be necessary to reflect the fact that no further activity under those contracts occurred during the months of October, November, and December, 1978.

Monthly Report No. 1 in assessing AT&T's interstate earnings. AT&T has supplied the IMR 1 reports to this Commission for approximately twenty-eight years as its summary of its interstate and foreign services operations. On July 25, 1979, AT&T, in response to specific questions as to measurement of AT&T's earned rate of return on interstate services for the calendar year 1978, stated:

> AT&T reports monthly to the Commission the interstate rate of return consistent with the Commission's past decisions as to the appropriate elements of revenues, expenses, taxes and net investment to be used in the calculation of the rate of return. *The report on which the interstate rate of return is shown is the interstate Monthly Report No. 1.*
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> * * * *
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> [t]he rate of return of 10.22% shown on the December 1978 Interstate Monthly Report No. 1 is the rate or return for 1978 based on the Commission's directives appropriate to that year, including the December 21 [IDC] decision mentioned above. [Letter from Mr. William Stump to the Chief of the Common Carrier Bureau, dated July 25, 1979.) (emphasis added)

14. On September 27, 1979, additional information was requested from Mr. Thomas Lawrence, a member of AT&T's FCC Financial and Accounting Matters Staff, as to the measurement of the revenues that AT&T had received during 1978 that were in excess of the 10.0 percent specified in our decision in Docket No. 20376. Specifically, Mr. Lawrence was asked to

> [p]lease state: (1) what total revenues for 1978 would have been required to achieve an after tax rate of return of 10.00 percent and (2) the income tax rates (federal, state, and if applicable, municipal) which have been applied to any revenues *which*

> *have resulted in earnings in excess of the 10.00% rate of return specified in Docket No. 20376.* (emphasis added)

In response thereto, Mr. Lawrence stated:

> Pursuant to your request, we have computed the revenues that would have been required to achieve an after-tax rate of return of 10.0% for the year 1978. The data utilized in the attached analysis indicates that *the revenues required to achieve a 10.0% return would have been $101.0 million less than the revenues shown on the Interstate Monthly Report No. 1 for the year 1978* as issued by AT&T on January 22, 1979. . . . (Letter from Mr. Thomas Lawrence, AT&T, dated October 26, 1979) (emphasis added).

15. In its comments in this proceeding, AT&T has also stated that an earned rate of return measurement of 10.22 percent would result in $101.0 million of revenues in excess of 10 percent.[18] In light of the information that is before us, we conclude that AT&T's 1978 interstate and foreign services revenues exceeded the level that was authorized by $101,000,000.[19]

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[18] AT&T Comments, para. 64.

[19] In the case before us here, there is no issue of tact that requires a trial type evidentiary hearing. We have relied upon the IMR 1 that AT&T has supplied to this Commission. AT&T's alternative measurements of its earned rate of return during 1978 (*vis.* 9.89 percent, 10.02 percent, 10.09 percent, 10.1 percent) have been rejected on the basis of our earlier decisions with respect to IDC (9.89 percent, 10.02 percent), and our assessment of the "1978 Annual FDC Report" (10.09 percent, 10.1) percent). The resolution of these measurement issues depends either upon the meaning of our prior decisions (see Appendix A, *infra*), or upon the fact that we accord no weight to the measurement of AT&T's rate of return that is contained in AT&T's 1978 Annual FDC Report. As AT&T noted in its Opposition to the NCCB petition, "the pertinent data are already before the Commission in reports routinely filed as well as previous correspondence . . . ." AT&T Opposition at 3, n.* (filed August 2, 1979).

16. The $101 million in excess revenues that AT&T received[20] during 1978 are exclusive of interest. In prior refund cases, it has been our policy to award simple interest at the rate that has been computed by the Commissioner of the Internal Revenue Service. Although comments suggested that another interest rate be adopted, we see no compelling reason to depart from that well established practice here.[21] It has also been the Commission's practice to compute interest from the date of the complaint.[22] In this case, however, we have determined that the final date for the determination of AT&T's excess revenues is at the conclusion of AT&T's fiscal year on December 31, 1978. Accordingly, interest shall be calculated from that date, rather than from the December 20, 1978, date of the GSA letter. The Internal Revenue Service interest rates that were applicable from January 1, 1979 are: 6 percent from January 1, 1979, through January 31, 1980; 12 percent from February 1, 1980, through January 31, 1982; 16 percent from January 1, 1983, through June 30, 1983; 20 percent from February 1, 1982, through December 31, 1982; 11 percent from July 1, 1983 through December 31, 1984; and 13 percent from January 1, 1985 to June 30, 1985.[23]

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[20] AT&T's reported gross revenues were based upon tariffs that included connecting and concurring carriers that received revenues through the division of revenues and settlements processes.

[21] The National Citizens Committee for Broadcasting, the Consumer Federation of America and the Missouri Public Interest Research Group requested that interest be accrued at the prime rate. The USOCA supported that request.

[22] *Teleprompter Inc.* v. *Chesapeake and Potomac Tel. Co.* 79 FCC 2d 232, 238-39 (1980), *recon.* 85 FCC 2d 23 (1981); *Georgia Power Co.* v. *Columbus Cablevision, Inc.*, FCC 84-100 (released March 20, 1984) at para. 9 n.9.

[23] Rev. Rul. 83-171, 1983-47 I.R.B. 7; Rev. Rul. 84-66; IRB 1984-18 (April 30, 1984). *See* references cited in para. 16 n.22, *supra.*

B. Restitution

17. The Notice of Inquiry requested comments on the action that this Commission should take when the earned rate of return exceeds the rate that has been authorized. Information in response to that request suggests that the mechanism that entails the least administrative expense would require the imposition of a temporary discount upon interstate services for a period that is sufficient to reduce carrier revenues by the amount that is to be restored to interstate ratepayers. During the time that has elapsed since comments were received in this proceeding, the Bell System Operating Companies have been divested from AT&T, the Division of Revenues process has terminated, access charges have been implemented, and earlier settlements procedures have been supplanted by the NECA administered distribution of access charges revenues under Part 69 of the Commission's rules.[24] Whatever weight might properly be ascribed to the conclusion that, in a pre-divestiture environment, temporary discounts on services are less expensive and more *efficiently* administered than cash refunds has added weight in the post-divestiture environment. In structuring an appropriate remedy, this conclusion is particularly compelling in light of the joint nature of the interstate services that were provided by AT&T, the Bell System Operating Companies, and the independent telephone companies during 1978. During that period, local exchange and other connecting carriers that received revenues that flowed from the provision of services pursuant to AT&T's interstate and foreign services tariffs also shared in aggregate revenues that were excessive. Traditional concepts of equity would, therefore, require that those entities that received excess revenues proportion-

[24] 47 C.F.R. § 69.601 et seq.

ately share the burden of restoring those revenues to the subscribers from whom they were received.[25]

18. Effecting restitution has been further complicated by the fact that it is virtually impossible to achieve a "direct targeting" of the amounts that should be refunded to particular recipients. Since 1978, ratepayers have died, changed names, and changed addresses. Corporations and other entities having *de jure* status as ratepayers during 1978 have been dissolved, estates have been liquidated and distributed, conservators have been appointed, and trustees in bankruptcy have become successors in interest to rights of bankrupt ratepayers in refunds. Moreover, even if each element within the class of 1978 ratepayers were still in existence and identifiable as ascertainable addresses, it would still not be possible to allocate the amount of 1978's excess revenues, with accrued interest, that should be directly refunded to each of those ratepayers without additional proceedings that would be extensive and time consuming. Also, as we have heretofore observed, we cannot conclude, on

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[25] Section 201(a) of the Communications Act empowers the Commission, after opportunity for hearing, to establish the division of charges among common carriers that engage in the joint provision of interstate and foreign telecommunications services. 47 U.S.C. § 201(a) (1982). Section 201(b) requires that all charges "in connection with such communication service shall be just and reasonable," and "any such charge . . . that is unjust or unreasonable is hereby declared to be unlawful . . . ." 47 U.S.C. § 202(a) (1982). We have concluded that AT&T's 1978 interstate tariffs yielded excessive reveneus to the providers of those services. As a consequence, it is not inappropriate to adjust the prospective division of charges among those carriers by their proportionate shares of the excess revenues that were received during 1978. We are herewith instituting the hearing that is required by Section 201(a) in the context of tariff revisions that we have required. *See* para. 25, *infra*. We recognize, in structuring the remedy that is contained herein, that the record in this proceeding is inadequate to permit a quantitative assessment of the restitution obligations of the independent telephone companies that participated in revenues that were derived from AT&T's 1978 tariffs.

the basis of AT&T's 1978 FDC study, that the proportions of the excess revenues that would be allocated to each tariffed service offering during 1978 would be correct.[26]

19. We have thus concluded that restitution can best be accomplished through a mechanism that will permit us to apply 1978's excess revenues, with accrued interest, to benefit subscribers utilizing the interstate and foreign telecommunications services of AT&T and its connecting and concurring carriers.[27] Accordingly, we direct

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[26] Para. 12, *supra*.

[27] *See Bebchick v. Public Uilities Commission*, 318 F.2d 187, 103-04 (D.C. Cir. en banc), *cert. denied*, 373 U.S. 913 (1963) (opinion permitting utility commission to fashion relief to benefit a class of ratepayers where individual ratepayers who had been overcharged could not be identified). In this case, we could have ordered an immediate discount. However, we have recently imposed revisions to interstate tariffs for switched services and have been conducting an extended review of the private line and special access service tariffs. Additional revisions to reflect changes in assets, expenses, and patterns of demand in exchange access tariffs will be necessary periodically. Because the imposition of unnecessary administrative expenses is undesirable, we have concluded that it will be more efficient to address the revenue requirement adjustments that we have required in the context of tariff revisions that will be occurring during 1985. This decision is based upon the fact we have previously established an orderly procedure for the annual revision of exchange carrier customer line charges, that provides for exchange carrier filings that are to have a scheduled effective date of June 1. *See* Section 69.3 of the Commission's Rules. Those revisions would ordinarily require changes in AT&T's interexchange tariffs, that would require an assessment of AT&T's supporting documentation. As a consequence, it would be administratively more efficient and less expensive to ensure that appropriate modifications have been made to interstate tariffs during the period that has been scheduled for that process, rather than providing for an additional round of tariff modifications and review on top of those that have been required in the context of our most recent orders. We have also concluded that it is not feasible to disproportionately allocate 1978's excess revenues, with accrued interest, among categories of interstate services on the basis of AT&T's 1978 FDC Report (see

AT&T to reduce its estimate of its 1985 revenue requirement by its proportionate share of 1978's excess revenues (including accrued interest),[28] and we further direct that the NECA shall reduce the estimated 1985 carrier common line pooled revenue requirements by the balance.[29]

C. Legal Authority

20. After a full hearing on the record, the Administrative Law Judge entered an Order in Docket No. 20376 that provided that AT&T's interstate earnings were not

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para. 12, *supra*). At this point, we feel that the administrative, technical, and data complexities, that are associated with effecting restitution in a timely manner, require that we adopt the approach that is contained herein.

[28] The "Plan of Reorganization" that implements the "Modification of Final Judgment" provides that contingent liabilities that relate to interstate rates be apportioned on the basis of "relative investment devoted to interstate services as of the effective date of divestiture (as calculated in accordance with the FCC-prescribed Separations Manual in effect on the date of divestiture), adjusted to reflect the assignments of assets under this Plan of Reorganization (CPE and InterLATA assets to AT&T, and intraLATA assets to the BOCs)." "Plan of Reorganization", filed in *United States v. Western Elec. Co. & AT&T*, C. A. No. 82-0192 (D.D.C., filed December 16, 1982) at 188. We find that such an allocation would be a reasonable and equitable division of the restitution obligations of the exchange and interexchange carriers.

[29] Interest on AT&T's pro rata share of the $101,000,000 shall be accrued from January 1, 1979, to the date upon which AT&T files tariff revisions that reflect the reductions in revenue requirements that have been ordered herein. The aggregate reduction in revenue requirements is to be allocated among the estimated revenue requirements for each service offering by a constant proportion (*e.g.* the revenue requirement of each service offering shall be reduced by a fraction that is equal to AT&T's total restitution obligation divided by AT&T's total 1985 interstate revenue requirement). Interest on the exchange carrier portion of the restitution obligation shall be computed from January 1, 1979, and shall conclude on the date that NECA files 1985 exchange carrier common line charges that reflect the restitution obligation that we have imposed today.

to exceed 10.0 percent.[30] After expressly affirming the decision of the Administrative Law Judge, the Commission stated that AT&T's earnings were "not to exceed 10 percent",[31] and further stated that it would "not require any downward adjustment of AT&T's overall interstate rates provided its overall rate of return does not exceed 10 percent." [32] AT&T did not, however, seek during 1978 to modify the rate of return prescription that AT&T now contends had been vacated by rapidly changing economic circumstances. Nor did this Commission or any court modify, during 1978, the Docket No. 20376 prescription orders. After receiving evidence during 1980, we did prescribe an interim date of return of 10.5 percent based upon the preliminary evidence that was then before us.[33] At that time we took care to point out that the Commission's Docket No. 20376 prescription orders had not lapsed, and that changes in AT&T's cost of capital could not "simply be determined by reference to changes in economic conditions without a hearing. Thus, we note that general fluctuations in the economy do not, as AT&T implies, weaken or invalidate an outstanding prescription such that a carrier may freely exceed it by filing increased rates." [34] The proper procedure for a car-

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[30] *AT&T Co.* (Docket 20376), 57 FCC 2d 979, 1005 (1975).

[31] *AT&T Co.* (Docket 20376), 57 FCC 2d 960, 973 (1976).

[32] *Id.*

[33] *See* AT&T Petition for Determination of Fair Rate of Return in CC Docket No. 79-63 (filed March 8, 1979). *AT&T*, 78 FCC 2d 661, 668-70, 672 (1980). Based in large measure upon information that was provided with respect to economic conditions during 1981, we subsequently concluded that AT&T's prescribed rate of return should be increased to 12.75 percent. *AT&T*, 86 FCC 2d 221, 251 (1981).

[34] *AT&T*, 78 FCC 2d at 666 n.7. Although AT&T contends that economic conditions during 1978 were sufficiently different to have vacated the 1976 prescription, we do not perceive AT&T's factual predicate to have been well founded. Our assessment of economic

rier who contends that an outstanding order is improper is to petition the Commission to modify that order.[35] During 1978 AT&T did not conform to the Commission's procedural rules by seeking an order that would have vacated the 1976 prescription order. Accordingly, there is no statutory basis that would lead to the conclusion that the 1976 prescription was not in full force and effect during 1978.[36]

21. We next turn to an argument that was raised by USITA. In discussing the Commission's authority under Section 205(a), USITA stated "[t]he FCC accepted the rates filed by AT&T in 1976. These rates became lawful rates, and AT&T could charge neither greater nor lesser rates. Yet this is precisely what the Commission would be doing in ordering refunds for 1978." [37] In essence, USITA appears to contend that the interstate tariffs under which AT&T was providing service during 1978 were "lawful rates." In this regard, several observations are in order. First, the Commission had never made an affirmative finding that any of AT&T's tariffed charges during 1978 were "just and reasonable" within the meaning of the Communications Act. Second, tariffed charges of AT&T that were in effect during 1978 had been found by this Commission to be unlawful (see Appendix B, *infra*, and references cited therein). The continuation of those services was permitted because the detrimental ef-

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and financial market conditions that are of public record with respect to 1978, as well as AT&T's interstate earnings during 1978, reaffirms our conviction that AT&T's prescribed rate of return was within the correlative range of economic and financial market conditions that we considered at the time of the rate of return prescription in early 1976.

[35] *See* Sections 1.2, 1.106, and 1.401 of the Commission's Rules, 47 CFR §§ 1.2. 1.106, and 1.401 (1978). Commission orders continue in force until the Commission or a court of competent jurisdiction issues a superseding order. 47 USC § 408 (1978).

[36] *See AT&T*, 78 FCC 2d at 665-70.

[37] USITA Comments at 5-6.

fects that would have resulted from a disruption in the provision of those services outweighed the harm that would result from the continued provision of those services at rates that had not been adequately justified. We did not, however, intend that AT&T's charges would result in revenues that exceeded the limit that we prescribed in Docket No. 20376.[38] USITA's contention that AT&T's interstate charges during 1978 were *ipso facto* lawful because they were filed at this Commission is incorrect. It is clear that under *Arizona Grocery v. Atchison, Topeka, and Santa Fe Railway Co.* that rates that become effective may subsequently be found to have violated statutory standards.[39] It is also clear under the Communications Act that a carrier is under an affirmative duty to revise its rates to conform to outstanding prescription order.[40]

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[38] *AT&T*, 57 FCC 2d 960, 973 (1976); *AT&T*, 78 FCC 2d at 667. *See also* Appendix B, *infra*, and citations contained therein. The difficulties that the Commission was encountering with respect to AT&T's tariffs are described in *Docket No. 18128*, 61 FCC 2d 587 (1976), *recon.*, 67 FCC 2d 1441 (1978); *Notice of Inquiry in CC Docket No. 79-245* (In the Matter of American Telephone & Telegraph Co. Manual and Procedures for Allocation of Costs), 73 FCC 2d 629 (1979); *WATS*, 66 FCC 2d 9, 51-56 (1977), *recon.* 69 FCC 2d 2031(1979); *DDS*, 67 FCC 2d 1195, 1229-30 (1978), *recon.*, 70 FCC 2d 616, 630-33 (1979). To the extent that services with associated charges that have been found to be unlawful have been provided through the use of plant that has been jointly used in the provision of other services at charges that have not been determined to be "just and reasonable", we confront a situation that, in the absence of enforcement of the overall rate of return prescription, would potentially permit carriers to achieve unlimited rates of return unless this Commision were to terminate the provision of those services.

[39] *Arizona Grocery v. Atchison, Topeka & Santa Fe Railway Co.*, 284 U.S. 370, 384 (1931). *See Caterfone*, 13 FCC 2d 420, *recon. denied*, 14 FCC 2d 571 (1986).

[40] Section 205(a) of the Communications Act of 1934, as amended, 47 U.S.C. § 205(a) (1978) (Commission may "prescribe what will be . . . thereafter observed . . . .").

22. Because Section 205(a) does not expressly contain the word "refunds", USITA further contends that any Commission action pursuant to a Section 205(a) prescription could not embrace refunds as a mechanism for remediation. While Section 205 does not specifically provide for the enforcement of Commission prescriptions through refund orders, Section 4(i) gives the Commission broad authority to "perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary in the execution of its functions." [41] In *Nader v. FCC*, the Court expressly recognized that the power to order refunds is inherent in the Commission's prescription authority.[42]

III. ORDERING CLAUSES

23. IT IS ORDERED That the GSA and NCCB petitions are granted to the extent stated in the rulings and procedures that have been adopted herein and are, in all other respects, denied.[43]

24. IT IS FURTHER ORDERED That restitution shall be effected as provided herein, and that changes in exchange carrier rates that implement this order shall be reflected in AT&T's estimated revenue requirements.

25. IT IS FURTHER ORDERED pursuant to Sections 4(i)-(j), 201, and 202 of the Communications Act, That comments may be filed within twenty (20) days from the date of each tariff filing that implements this

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[41] 47 U.S.C. § 154(i) (1978). With respect to the relationship between Section 4(i) and Section 205(a), the Court in the *Nader* case stated that the "discretion that must be afforded the Commission in the exercise of its ratemaking power is enhanced by Section 4(i) of the Communications Act . . ." *Nader v. FCC*, 520 F.2d 182, 203 (D.C. Cir. 1975).

[42] *Nader v. FCC*, *supra*, at 204-05 n.25.

[43] *See AT&T Co.* (Order Instituting Hearing), *supra*, at 690 n.4.

Order, and reply comments may be filed within ten (10) days thereafter.

26. IT IS FURTHER ORDERED That the Secretary shall cause this decision to be published in the Federal Register.

27. IT IS FURTHER ORDERED That the Secretary shall, by registered mail, serve a copy of this decision and notice of hearing upon the American Telephone and Telegraph Company and each of the Bell System Operating Companies in accordance with Sections 416 and 413 of the Communications Act of 1934, as amended, and shall enter proof of service in the docket in this proceeding.

28. IT IS FURTHER Ordered that the Secretary shall transmit a copy of this order to the NECA.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

APPENDIX A

Interest During Construction

1. In correspondence with the Common Carrier Bureau, and in its comments in this proceeding, AT&T has asserted that the earned rate of return measurements that AT&T reported in the IMR 1 and the 1978 Annual FDC Report should be reduced by 0.20% on the basis of "full compliance" with Docket 19129 (Phase II). In the interest of brevity, those adjustments shall be referred to hereinafter as either the "Interest During Construction" or "IDC" adjustments. The 9.89% measurement of AT&T's earned rate of return for 1978 results from the deduction, by AT&T, of 1978's Interest During Construction from the revenues that AT&T's employed in presenting the 10.09% 1978 earned rate of return figure that was contained in AT&T's FDC Report. Similarly, the 10.02% measurement results from deducting IDC from the 10.22% figure that AT&T filed in its IMR-1 Report for December, 1978. To understand the nature of AT&T's contentions it is necessary to review "IDC" concepts and our decisions with respect to IDC from the ratemaking perspective that is relevant here. Subsequent paragraphs in this. Appendix discuss IDC, our decisions with respect to IDC, AT&T's correspondence with respect to IDC, and the measurement of AT&T's earned rate of return during 1978.

2. When a utility constructs plant, the construction of the plant is frequently, although not necessarily, financed through the issuance of interest bearing debt. Inclusion of the interest that was incurred to finance the plant construction could result in "double counting" [1] and there-

[1] The "double counting" would occur as a consequence of allowing the carrier to earn its allowed rate of return (cost of capital) on the funds which were being used for constructing plant, while, at the same time permitting the carrier to accrue "interest during construction" which the carrier is subsequently permitted to recover from ratepayers.

fore a double recovery to the carrier if the plant that was under construction were also included in the carrier's rate base for allowed rate of return measurement purposes. As a hypothetical example of this possibility, assume that during 1978 a carrier had $573,478,000 of telephone plant under construction and had incurred $46,786,000 in interest during 1978 to finance that plant while it was under construction. If that carrier were permitted to earn an allowed rate of return of 10% on the plant under construction in its revenue requirements *for that year*, and also receive IDC, the carrier would have been permitted to earn $104,133,000[2] or 18.16%[3] on that investment as compared with the allowed rate of return of 10%.

3. The issue that AT&T raised in its letters of January 19, 1979, May 3, 1979, and in its comments with respect to IDC had its genesis in our consideration of AT&T's network capacity in the *Phase II Final Decision and Order in Docket No. 19129*, 64 FCC 2d 1, 44-60 (1977). At that time, we noted that our practice had been to "[i]nclude plant under construction in the rate base and charge interest during construction. The interest during construction is included in income for ratemaking purposes and is added to the construction work in progress to be included in utility plant when the construction work is placed in service." *Id.* at 56. An explanation of that treatment for rate making purposes will help to clarify the background that underlies AT&T's proposed adjustment.

4. Upon occurrence of the condition that the constructed plant is actually placed in service,[4] AT&T has been permitted to add IDC to the cost of that constructed

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[2] ($573,478,000) (.1) + $46,786,000 = $104,133,000.

[3] $104,133,000/$563,478,000 = .1816, or 18.16%.

[4] See *Phase II Final Decision and Order in Docket No. 19129*, 64 FCC 2d 1 45-53, 56-62 (1977).

plant, which, in turn, was then included in AT&T's rate base and depreciation expense for ratemaking purposes. To avoid "double counting", in the period(s) prior to the constructed plant's actual commitment to service (and subsequent thereto), we required, for ratemaking purposes, that while the plant was being constructed (termed "construction work in progress") the interest that was being incurred on the construction be *added* to the revenues of the carrier to offset the rate of return which the carrier was being permitted to earn upon the plant while it was being constructed. Not including the credit to revenues of IDC for ratemaking purposes would have resulted in the following consequences: (1) the carrier would be permitted to earn a rate of return on plant under construction; (2) the carrier would then be permitted to take the portion of return which was associated with the construction of the plant (IDC) and place that money in the rate base (thereby being compensated twice for the use of the money necessary for construction of the same plant); and (3) the carrier would subsequently be permitted to earn the allowed rate of return upon the IDC, for which the carrier has already been compensated when the carrier had been permitted to earn a rate of return on the plant while it was under construction (see (1), above).

5. A numerical illustration of these concepts may be helpful. Assume that a carrier's allowed rate of return is ten percent, that the carrier borrows at ten percent to finance construction, and that $10,000 in construction expenditures occur during 1978. Under this scenario, the carrier is permitted to recover its cost of capital (the allowed rate of return of ten percent) on the construction, or $1,000 ($10,000 x .1) during 1978. The subsequent inclusion of IDC ($10,000 x .1 = $1,000) during 1978 in the carrier's rate base would permit the carrier to recover a second round of capital costs (the "double count") when that carrier is subsequently permitted to

recover the $1,000 of IDC in increased depreciation expense in subsequent time periods, and is also permitted to earn the allowed rate of return upon the IDC that is in the rate base. The offsetting entry that we had required from Docket No. 16258, 9 FCC 2d 960, 972 (1967), *reduced* the revenue requirement *by adding*, for *rate evaluation purposes*, IDC to the revenues that the carrier was receiving. This had the direct effect of increasing the measurement of the carrier's earnings for *ratemaking* purposes.

6. The treatment of IDC that was discussed in the three preceding paragraphs was examined by the Trial Staff in Docket No. 19129. In our *Phase II Final Decision and Order in Docket No. 19129*, *supra* at 60, we found "sufficient merits in the Trial Staff's criticism of our present procedures for treating PUC and IDC to institute changes to eliminate some of the problems it has asserted." Specifically, our Order stated:

> [w]e shall continue the practice . . . of including short-term construction projects in the curent rate base as the investment is incurred. We shall, however, neither compute nor capitalize IDC on such amounts, but rather . . . treat short-term projects similarly to plant in service.
>
> * * * *
>
> Furthermore, we shall require all projects which actually take longer than one year to complete to be removed from the rate base at the end of the year, unless given a waiver by this Commission. In that event, IDC will be computed starting at the end of one year in accordance with the procedures set forth below. Additionally, any project suspended longer than six months will be removed from the rate base and no IDC will be computed on such amounts. Projects designed with construction time exceeding one year will be removed from the rate base *ab initio* . . . .

64 FCC 2d 1, 59 (1977). In addition, we explained that:

> [w]e realize that changes to the Uniform System of Accounts will be required in order to implement these rate base changes, as projects with completion dates exceeding one year must be isolated from those taking less than one year. We are also concerned that the necessary accounting changes are not inconsistent with regulatory systems of the several states. Accordingly, we are by separate Order instituting a proceeding, pursuant to Section 220(i) of the Act . . . , to solicit the views of the states on the proposed accounting changes.

Id. at 60.

7. The proceeding to amend the Uniform System of Accounts ("USOA") as suggested in Docket No. 19129 was instituted by a Notice of Proposed Rulemaking, which was adopted on April 28, 1977 (Docket No. 21230), and published in the *Federal Register* on May 13, 1977, 42 *Fed. Reg.* 24291). In that Notice, we pointed out that in our *Phase II Final Decision and Order* in *Docket No. 19129* we had "prescribed, among other things, the treatment of certain plant and expense items for ratemaking purposes"; that "[a]lthough the investigation in Docket No. 19129 was limited to the operations of [AT&T] . . . the conclusion reached therein should be rules of general applicability"; and, that the USOA "should therefore reflect the view expressed in Docket No. 19129 that "orderly implementation of certain of those prescriptions [including plant under construction] will require amendment of the Uniform System."

8. On February 24, 1978, subsequent to the institution of the rulemaking proceeding to modify the necessary accounts, we considered on our own motion (FCC 78-103, 67 FCC 2d 1429) the problem of plant under construction and IDC in Docket No. 19129 and observed that:

> [u]nder the provisions of our decision [Docket 19129], see para. 322, our revised treatment of Plant Under Construction (PUC) and Interest During Construction (IDC) for ratemaking purposes became effective for reporting year 1977. It was also originally determined that certain changes to our accounting rules were necessary for the orderly implementation of our revised policy. Accordingly, on May 9, 1977, we released a Notice of Rulemaking for comment by various states regarding the proposed amendments to the Uniform System of Accounts . . . . Until that time [*i.e.*, until the USOA is amended in accordance with the requirements of Section 220 of the Act], *present accounting rules will remain in effect, although, for ratemaking purposes*, interest is not to be calculated on projects scheduled to be completed in less than one year.

67 FCC 2d 1429, 1435-36 (emphasis added).

We further stated:

> [*w*]*e are using this opportunity to clarify the rate base treatment of IDC accrued before the effective date of the above accounting change. For the reason stated below, we find the appropriate treatment is to disallow such IDC for ratemaking purposes* during calendar year 1977. Traditionally, IDC has been designed, in part, to compensate investors for funds prudently invested in construction projects, since projects while under construction generally generate neither revenues nor profits. However, because we are allowing investment in construction projects that are completed in less than one year to be included immediately in the rate base, AT&T will have the opportunity to earn an immediate fair return. *To allow AT&T the additional opportunity to capitalize IDC at the time the associated PUC goes into service, and thus to recover such IDC over*

> *the life of the facility, would compensate AT&T's investors twice. We find such "double counting" not to be in the public interest and shall therefore disallow such IDC, effective January 1, 1977, from respondent's interstate rate base.*

Id. at 1436 (emphasis added).

9. About a month later, on March 27, 1978, Mr. William R. Stump, AT&T Assistant Vice President for FCC Financial and Accounting Matters, wrote to the Chief of the Common Carrier Bureau seeking additional information as to the treatment of IDC. The letter stated:

> [i]t is clear that the Commission intends to disallow the inclusion of IDC from the rate base, for ratemaking purposes, during the pendency of changes in the Uniform System of Accounts to avoid any possibility of "double dipping" during the Docket 19129 (Phase II) Final Order and the necessary accounting changes in Docket 21230.
>
> It also appears to be the Commission's intent in Paragraphs 14 and 15 to restore this IDC to the rate base once the new accounting changes go into effect and the opportunity for "double dipping" no longer exists.
>
> While this is a logical approach and appears to be the intent of the Commission, the wording in Paragraphs 14 and 15 is not as clear as it might be in this regard. It would be helpful if this point could be clarified in the Order prescribing the necessary accounting changes.

In reply, the Bureau Chief agreed with AT&T's interpretation that the Commission's intent in Docket No. 19129 was to exclude IDC from the rate base for ratemaking purposes pending necessary accounting changes as a means of avoiding the opportunity for "double dipping." On the other hand, unlike AT&T, the Bureau

Chief did "not read the Commission's orders as evidencing an intent to restore the IDC to rate base once the new accounting changes prescribed by Docket 21230 become effective."

10. On May 11, 1978, the Commission issued the *Amendment of Part 31 Report and Order* (Docket No. 21230), 68 FCC 2d 902. Consistent with our findings in Docket No. 19129, our decision in Docket No. 21230 amended the USOA to require, *inter alia*, that the *account* for telephone plant under construction be subdivided into two parts: one to show those projects to be completed in more than a year (long-term projects). Basically, those projects to be completed within one year were to be placed in the plant accounts immediately and no IDC was to be accrued thereon. Long term projects (*e.g.* those which are to be completed in more than one year) were to accrue IDC but were to be placed in plant accounts only when ready for service. Those *accounting* changes were ordered to become effective on January 1, 1979. See *Amendment of Part 31, supra*, at 908; *recon.*, FCC 79-678 (released November 6, 1979).

11. On June 2, 1978, AT&T filed an "Application For Review" challenging the conclusions reached by the Bureau Chief in his May 8, 1978, letter "as contrary to statutory requirements, case precedent, the Commission's decision in Docket 19129 Phase II and Commission policy." AT&T requested that we set aside the Bureau Chief's conclusions and hold instead:

1. that IDC accrued by AT&T on short term Plant Under Construction in 1977 and 1978 was allowable for interstate ratemaking purposes; and

2. that the Bureau Chief exceeded his authority in concluding that interest accrued on short term plant during 1977 and 1978 should be written off AT&T's books as an unrecoverable cost.

AT&T's Application For Review also stated:

> [w]hile it is true, as [the Common Carrier Bureau Chief's] letter states, that "capitalized IDC is recovered through increased depreciation charges over the life of the plant on which IDC was initially accrued" *this does not amount to double counting, so long as the IDC is included as income for ratemaking purposes . . . (emphasis added)*

12. Thus, AT&T's June 2, 1978, Application For Review requested, for ratemaking purposes during 1977 and 1978, that this Commission continue in effect the IDC treatment that AT&T was then using for accounting and ratemaking purposes in its IMR 1 reports which was, in fact, the same accounting and ratemaking treatment that this Commission had prescribed in 1967 in Docket No. 16258. *As noted above, AT&T expressly stated that IDC, under that method, must be included with income for ratemaking purposes to offset the "double counting" that would otherwise result.* Upon further consideration, we granted AT&T's request that had the consequence that insofar as the ratemaking treatment of IDC on Plant Under Construction was concerned for 1977 and 1978, *AT&T would continue its existing reporting of IDC* (which included the revenue credit of IDC to offset "double counting") and that our ratemaking assessment would correspond thereto.[5]

13. Against this factual backdrop, we now consider AT&T's statements regarding the appropriate treatment of IDC during 1978 insofar as they concern the measurement of AT&T's earned rate of return for 1978. On January 19, 1979, AT&T stated, with respect to AT&T's earned rate of return during 1978: "[i]n 1978, on the basis of full compliance with Docket 19129 (Phase II)

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[5] *See In the Matter of the American Telephone and Telegraph Co.*, 72 FCC 2d 1 (decided December 21, 1978; adopted in final form on May 30, 1979; released June 1, 1979).

requirements it was 10.02%—for all practical purposes, right at the upper part of the range . . . ." (Letter from Mr. William Stump, AT&T, to the Acting Chief of the Common Carrier Bureau, dated January 19, 1979).

14. On May 3, 1979, in response to a letter by the Chief of the Common Carrier Bureau with respect to the 10.02% measurement, AT&T stated:

> [y]ou ask that we fully explain the difference between the 10.22% rate of return reported on the Interstate Monthly Report No. 1 (IMR 1) and the 10.02% rate of return mentioned in my letter as having been calculated on the basis of full compliance with the Docket 19129 (Phase II) requirements.
>
> The 20 basis point difference between the 10.22% reported on the December 1978 IMR 1 as the 1978 interstate ratio of net earnings to average net investment and the 10.02% ratio mentioned in my letter to you as the 1978 ratio on the basis of full compliance with the Docket No. 19129 requirements *results from the adjusting out of amounts of interest during construction accrued on short-term plant under construction in 1978* (see Attachment). The 1977 and 1978 operating results reported in the 1978 IMR 1's reflected the Docket No. 19129 decision except for the accrual of these amounts of interest during construction because the changes to Part 31 of the Commission's rules which would result in full implementation of this Decision in this regard were not effective until January 1, 1979. (Letter from Mr. William R. Stump, AT&T, to the Chief, Common Carrier Bureau, dated May 3, 1979.) (emphasis added)

15. In response to further inquiry as to the measurement of AT&T's earned rate of return during 1978, Mr. Stump stated, in a letter to the Chief of the Common Carrier Bureau that was dated July 25, 1979: "[t]he

rate of return of 10.22% shown on the December 1978 Interstate Monthly Report No. 1 is the rate of return for 1978 based on the Commission's directives appropriate to that year, including the December 21 decision-mentioned above."

16. In its comments in this proceeding, AT&T has stated: "[t]he 10.02 and 9.89 percent measurement differ from the 10.22 and 10.1 percent measurements, respectively, only in that the former two measurements, but not the latter two, reflect full implementation of the Commission's Phase II decision in Docket 19129." (AT&T comments, para, 63.) AT&T further stated, in a footnote to paragraph 64 of its comments, that: "[t]he 10.1 percent was a rounding of a 10.09 percent, so that the excess is only 9 basis points."

17. Thus, AT&T has stated in its letter of May 3, 1979, and in its comments in this proceeding that the difference between 10.02% and the 10.22% reported in AT&T's December, 1978, IMR 1 results from AT&T's "adjusting out" IDC for 1978. Similarly, the 9.89% measurement supplied in AT&T's comments (paras. 60, 63, 64) results from AT&T's "adjusting out" IDC for 1978 from the 10.09% earned rate of return that AT&T reported in its "1978 Annual FDC Report." As heretofore noted, those proposed downward IDC adjustments ad the earned rates of return measurements associated therewith have been rejected. As we have heretofore stated *for ratemaking as well as for accounting purposes during 1978, IDC must be added to AT&T's revenues for interstate and foreign services to prevent double counting.* In its June 2, 1978, Application For Review, AT&T acknowledged that IDC must be added to income to prevent double counting during 1978 (see para. 11, *supra*), and our June 1, 1979, Memorandum Opinion and Order expressly recognized that fact. *See Memorandum Opinion and Order In The Matter Of The American Telephone and Telegraph Company,* 72 FCC 2d 1, 6 (1979).

The "full implementation of the Commission's Phase II decision in Docket 19129" to which AT&T refers (AT&T comments, para. 63; AT&T letters of January 19, 1979, and May 3, 1979) not only involved accounting changes that were effective on January 1, 1979, *but also involved concommitant ratemaking changes to prevent double counting that were also not effective until January 1, 1979.* AT&T's proffered "full implementation" of our Phase II Decision in Docket No. 19129, by now including for 1978 inapplicable January 1, 1979, accounting changes (which intentionally were not to become effective until January 1, 1979), would, for 1978, result in the exact result that we have consistently sought to avoid: a double recovery of IDC.

APPENDIX B

1. This Appendix contains a brief history of AT&T filings and FCC proceedings that relate to tariffs under which AT&T was providing interstate services during 1978.

2. On January 29, 1976, AT&T filed "Transmittal No. 12497" which contained revisions to Tariffs FCC Nos. 259, 260, 263, 264, and 267, which were represented as having been designed to yield a 9.5% rate of return. On February 5, 1976, after a full hearing, the Commission released a Memorandum Opinion and Order in Docket No. 20376, 57 FCC 2d 960 (1976), which prescribed a fair rate of return for AT&T of 9.5% and permitted AT&T to earn an additional 0.5% as "an incentive to increased productivity and efficiency." *Id.* at 973. On March 1, 1976, we released a Memorandum Opinion and Order in Docket No. 20732, 58 FCC 2d 1 (1976), which considered the tariff revisions that we contained in Transmittal No. 12497. As noted therein, numerous issues were raised by participants in that proceeding that were also, in part, being considered in Docket Nos. 18128, 19989, and 20288. Accordingly, pursuant to Sections 4(i), 4(j), 204, 205, and 403 of Communications Act of 1934, as amended, the tariff revisions that were contained in Transmittal No. 12497 were suspended for one day, a hearing was instituted into the lawfulness of those tariff revisions, the hearing was held in abeyance pending further order of this Commission, and we required "that AT&T maintain an accounting of the revenues derived under these revised tariffs, for possible refund upon resolution of the lawfulness thereof." *Id.* at 5. On March 26, 1976, we released an "Errata" in Docket No. 20732, FCC 76-248, 58 FCC 2d 905 (1976), which, *inter alia*, revised paragraph 14 of our Memorandum Opinion and Order in Docket No. 20732, *supra*, at 5, to read:

> [f]or the reasons indicated we shall order AT&T and all participating telephone companies to maintain accounts by service classes and sublcasses, [*sic*] in the aggregate, specifying the amounts of all increases and the service classification for which such amounts are accounted. Classifications for which accounts must be kept are as follows: (1) private line services, by series; (2) MTS and WATS, insofar as rates have been increased, and for each classification of service (e.g., dial station, operator-assisted, inward WATS, outward WATS, etc.); (3) DDS; and (4) all other services.

58 FCC 2d 1, 5 (1976). Service of the Errata upon AT&T was effected on March 26, 1976. On March 29, 1976, the Commission released a Memorandum Opinion and Order in Docket No. 20736 (In the Matter of American Telephone and Telegraph Company Revision to Tariff FCC No. 260 (Series 1000), 58 FCC 2d 899 (1976), which similarly provided for the suspension of certain AT&T tariff revisions, the institution of a hearing at a date to be specified, and the imposition of an accounting order upon AT&T and upon all carriers participating in the provision of the Series 1000 service. *Id.* at 903. In our Final Decision and Order in Docket No. 19989, 59 FCC 2d 671, 709-10 (1976), after having found the WATS tariff filings at issue therein to be unlawful, we stated

> [a]lthough the WATS tariff has been found unlawful as indicated herein, there is a clear public interest requirement for continuity of Inward and Outward WATS service to the public. Further, this procedure will avoid the confusion and administrative difficulties which would likely arise if an alternative WATS tariff was filed to become effective during the interim period while Bell prepared the tariff filing required by our Decision. Finally, we note that existing accounting orders shall continue as set forth

herein to protect the public and we retain our rights to investigate or reject or impose an accounting order with respect to the tariff revisions which Bell must file. In view of the foregoing, the course outlined above will best serve the public interest.

Our Designation Order herein imposed an accounting order by individual customer account on Bell for all charges which were increased under the filing of Transmittal No. 11935, 46 FCC 2d at 86. No accounting order was imposed for the increased charges resulting from Bell's March 1975 filing under Transmittal No. 12303, 52 FCC 2d 155, 156, and a 'class' accounting order was imposed for the increased charges resulting from Bell's February 1976 filing under Transmittal No. 12493, Docket No. 20732, 58 FCC 2d 1, 4-5 (1976). Moreover, an accounting order by individual customer account remains outstanding with respect to the 1973 WATS rate increases, 40 FCC 2d 18, 20. As indicated above, we have found the foregoing WATS tariff filing unlawful. In the normal case where charges are found unlawful after hearing, we would prescribe lawful rates, and therefore know what portions of the increases are lawful. Here, however, we have an insufficient record to support a rate prescription, and we therefore believe it an appropriate exercise of our discretion not to order any refunds pending consideration of the tariff revisions filed in accordance with this Decision. Accordingly, we will leave the accounting orders now pending in effect. However, to the extent possible, we shall order Bell to convert the existing accounting orders by individual account into "class" accounting orders, i.e., for Outward MT, Outward FBD(FT), Inward MT and Inward FBD(FT) services, upon the effective date of this decision . . . .

* * * *

> IT IS FURTHER ORDERED, that the accounting orders pursuant to 40 FCC 2d 18, 20 and 46 FCC 2d 81, 86 SHALL BE CONVERTED to class accounting orders (for Outward MT, Outward FT/FBD. Inward MT, Inward FT/FBD categories of service) insofar as feasible.

Id. at 709-10. By subsequent Memorandum Opinion and Order in Docket No. 19989, 64 FCC 2d 538, 540-41 (1977), which was released on April 18, 1977, we clarified the earlier accounting orders in Docket No. 19989, *supra*, at 709-10, by stating:

> [i]n its Reply to AT&T's Opposition, National Data restates its view that existing individual accounts should not be destroyed nor converted to class accounts if the effect would be to eliminate the basis for possible individual customer refunds, for WATS customers who have relied upon the accounting order by individual account issued by the Commission for the period March 14, 1973 to March 8, 1975 as the ultimate source of relief. National Data points out that with respect to future individual account record keeping it has not sought to require compilation of such records. It also does not deny that it is "concerned about its own hopes for a refund," claiming it has suffered several dramatic increases in its WATS charges since 1973, much to the detriment of its business operations and economic well being. National Data further renews its request that the Commission provide AT&T's WATS customers some indication as to its view of the likelihood that individual refunds, for the years 1973, 1974 and 1975, will be ordered so that if necessary, such customers may consider seeking alternate relief. Finally, National Data claims its participation in the informal discussions between AT&T and the Bureau will be of assistance due to its thorough knowledge of the issues which it obtained as a party to Docket No.

> 19989. To the extent indicated below, we grant the relief requested by National Data. In regard to National Data's concern about accounting orders and records, our March 1, 1976 action in Docket No. 20732, *supra*, sets forth the public policy reasons justifying the entry of class accounting orders and supports the conversion of accounting orders by individual customer account to class accounting orders as ordered in this particular case. In our March 1, 1976 action, 58 FCC 2d at 4, we stated that "[i]n major rate cases . . . , the imposition of individual accounting requirements [is] a costly, ineffective means of protecting the public interest." Although we ordered the conversion to class accounting, and reaffirm that decision here, we never expected AT&T to physically convert the two accounting orders until we first decided whether or how any alleged refund liability was to be considered or determined. See 59 FCC 2d at 709. Thus, no destruction of existing individual account records, which is National Data's major concern, has occured or will occur in the future pending further Commission order.

64 FCC 2d 538, 540-41. In the Phase II Final Decision and Order in Docket No. 19129, 64 FCC 2d 100-01, 110, released on March 1, 1977, we terminated the outstanding accounting orders with respect to AT&T's Message Telecommunications Service. On May 9, 1977, this Commission issued a clarifying Memorandum Opinion and Order, FCC 77-310, which, *inter alia*, stated:

> [O]n March 1, 1977, we released the Phase II Final Decision and Order in our Docket No. 19129 investigation of AT&T, FCC 77-150, 64 FCC 2d 1. We found in that proceeding, *inter alia*, that the rate level of AT&T's Message Telecommunications Service (MTS), reflected in the earnings ratio from the service through 1975, was just and reasonable during the period of this proceeding. Para. 253. Ac-

> cordingly, we concluded that maintenance of the outstanding accounting orders, with the costs thereof placed upon the operating expenses of AT&T, was no longer required and terminated all such accounting orders with respect to MTS. Paras. 276, 328. In the Phase II Final Decision, *supra*, we found the overall rate levels of MTS reasonableness of the MTS rate level in that filing remains under question (footnote omitted), we believe it inappropriate to terminate the MTS 1976 accounting order. Therefore, we hereby clarify that para. 328 of the Phase II Final Decision, *supra*, does not terminate the accounting order in this proceeding [Docket No. 20732].
>
> Accordingly, IT WAS ORDERED, That the accounts ordered in this proceeding at 58 FCC 2d 1, 5 (1976) shall continue to be kept until further order of this Commission.

3. On May 9, 1977, the preceding Memorandum Opinion and Order in Docket No. 20732 was served upon AT&T. Pursuant to Section 408 of the Communications Act of 1934, as amended, 47 USC § 408, that order remained in full force and effect during 1978.

4. By Memorandum Opinion and Order in Docket No. 18128, 61 FCC 2d 587, 669 (released October 1, 1976), this Commission terminated all extant accounting orders in Docket No. 18128. However, upon reconsideration, by Memorandum Opinion and Order released on June 13, 1977, 64 FCC 2d 971, 933, we reinstituted the accounting orders in Docket No. 18128. Upon further reconsideration, Second Order on Reconsideration in Docket No. 18128, 67 FCC 2d 1441, 1453 (released February 24, 1978), we reaffirmed the reinstitution of the extant accounting orders in Docket No. 18128, and stated:

> [a]s noted above, certain rate increases were found unjustified while others like Telpak are still subject

> to further proceedings. This circumstance allows that certain users may have been overcharged and may be entitled to refunds either presently or at the outcome of the proceeding. Clearly, the carrier, which has the burden of justifying its rates, should carry the risk of failure in the proceeding, not the customer. AT&T would have us place the customer in the position of bearing the entire risk of overpayment in the event that rates are proven unlawfully high. We must reject the view, and therefore hold that maintenance of the accounting orders is necessary to continue to protect customer interests still extant in this proceeding.

Id. at 1453.

5. During 1978, AT&T had in effect several tariffed rates that the Commission has found to be unlawful or that have been continued pursuant to Court order. During April 1976, AT&T filed Tariff revisions 12546 and 12547 introducing the multi-schedule private line (MPL) rates. On May 19, 1976, the Commission suspended the effective date of the MPL rates, and set those rates for investigation. In the Matter of American Telephone & Telegraph Company, 59 FCC 2d 428 (1976). At that time, we stated:

> [s]ubstantial questions have been raised concerning the lawfulness of the MPL rate structure. Some of the specific features of the tariff which need close scrutiny are, among others, the increases in the charges of services of 25 miles or less in length, the high charge for the first mile of service, the possible anti-competitive implications of the decreases in charges for long haul services, and the possibility of unlawful discrimination between users.

Id. at 431. The MPL rates became effective on August 20, 1976, following expiration of the three-month suspension period. Those rates remained in effect with minor

revisions through 1978. On March 19, 1979, the Administrative Law Judge, after a lengthy hearing, released his decision. As reported in the Commission's final decision, the Administrative Law Judge:

> found eight separate violations of Docket No. 18128 requirements in the MPL cost studies. He thus concluded, that the costing practices and classifications underlying those cost studies are not just and reasonable within the meaning of Section 201(b) of the Communications Act (47 USC § 202(b)); that AT&T has failed to demonstrate that such classifications and practices would not constitute an unjust or unreasonable discrimination in violation of Section 202(a) of the Act. (47 USC § 202(a)); and that AT&T has not met or even attempted to meet the cost allocation guidelines set out in the Docket No. 18128 Decision. The Judge concluded that the Series 2000/3000 transmittals at issue are unlawful and must be rejected.

In the Matter of American Telephone and Telegraph Company, 74 FCC 2d 1, 7 (1979). On September 20, 1979, the Commission in its Final Decision in Docket No. 20814 found that as a consequence of the use of AT&T's basic service philosophy, AT&T had "failed to carry its burden of justifying the MPL tariff under Section 201(b) of the Act in accordance with Docket No. 18128 requirements." 74 FCC 2d 1, 41 (1979). The Commission then concluded that the public interest required that AT&T's tariff remain in effect until the Commission was in a position to prescribe new rates, or until a new carrier initiated tariff became effective. In the Commission's Final Decision and Order in Docket No. 19989, 59 FCC 2d 671 (1976), *recon.*, 64 FCC 2d 538 (1977), the Commission, in considering AT&T's WATS tariff rates, concluded that:

> pursuant to Section 201(b) and 202(a) of the Act, the tariff schedules filed with Bell Transmittal Nos.

> 11657 and 11935 (and revisions thereto) are found unlawful as indicated herein, ARE NULL AND VOID, effective 210 days after publication of this Decision in the Federal Register.
>
> IT IS FURTHER ORDERED, That Bell shall file tariff revisions accompanied by the information required by Section 61.38 of the Commission's Rules, 37 CFR 61.38, and which meet the guidelines specified herein;
>
> * * * *
>
> IT IS FURTHER ORDERED, That the provisions of Section 61.58 of the Commission's Rules, 47 CFR 61.58, ARE WAIVED, and the tariff revisions to be filed on not less than 60 days notice; 59 FCC 2d 671, 709-710.

In response to this order, AT&T filed Transmittal 12745 which was to become Effective on August 1, 1977. On July 21, 1977, the Commission concluded that

> AT&T's WATS tariff filing, Transmittal No. 12745, IS REJECTED, except to the extent WATS services are to be initiated to and from points outside the 48 contiguous states . . . .
>
> IT IS FURTHER ORDERED, That the effective date of paragraph 90 of our Decision in Docket No. 19989, 59 FCC 2d 671, 709-710 (1976), which declared the present WATs tariff null and void IS DEFERRED, pending further Commission Order.

In the Matter of American Telephone and Telegraph Company (Long Lines Department) Revisions to Tariff FCC No. 259 Wide Area Telecommunications Service (WATS), Transmittal No. 12745, 66 FCC 2d, 62-63 (1977).

6. On November 21, 1978, the Commission, in the preceding WATS Decision, set forth a mechanism for the filing of revised WATS tariffs. Thus, the WATS

tariffed rates, found to be unlawful in 1976, remained in effect during 1978 with the minor exceptions noted above. On January 17, 1977, the Commission released the Memorandum Opinion and Order In The Matter of American Telephone and Telegraph Company Investigation Into The Lawfulness Of Tariff FCC No. 267, Offering A Dataphone Digital Service Between 5 Cities (Docket No. 20288), 62 FCC 2d 774 (1977), *recon. denied*, 64 FCC 2d 994 (1977), regarding the provision of dataphone digital service. In that Decision, the Commission stated:

> [T]he rates and conditions of AT&T's Tariff No. 267, as specified herein, are unjust, unreasonable, and unlawful, in violation of § 201(b) of the Communications Act . . . . Accordingly, we require AT&T to file an interim tariff offering dataphone digital service at rates designed to yield the 9.5% return, as provided herein, no later than February 22, 1977, effective on thirty days notice.

62 FCC 2d 774, 807 (1977). AT&T filed interim rates patterned after the rates in Tariff No. 260 (Series 2000/3000) under Transmittal 12687 which became effective on March 24, 1977. In allowing those tariffed rates to become effective, the Commission stated:

> [we] find that AT&T has substantially complied with our guidelines set forth in the Docket 20288 Decision. Upon examination of the arguments in the petitions for investigation and rejection, we cannot agree that the requested relief is warranted. Therefore, we will show the tariff revisions which reflect the interim rates to become effective.

In The Matter Of American Telephone and Telegraph Company, 63 FCC 2d 936, 937 (1977). On July 25, 1977, AT&T filed revised Dataphone Digital Service ("DDS") tariffs under Transmittal 12790 to become effective on January 16, 1978. On January 12, 1978, the

Commission rejected proposed DDS tariff rates on the ground that the filing did not comply with the Commission's Order in Docket No. 20288. In The Matter Of American Telephone and Telegraph Company Revisions Of Tariff No. 267 Dataphone Digital Service (DDS), 67 FCC 2d 1195 (1978), *recon. denied*, 70 FCC 2d 616 (1979). Since its initial tariff offering service to five cities, AT&T expanded in phases the number of cities to be served. Each incremental tariff filing for each incremental service was based upon the interim rates that were filed in 1977.

7. On October 1, 1976, the Commission released its Memorandum Opinion and Order in Docket No. 18128, 61 FCC 2d 1444 (1978), *aff'd. sub nom.* Aeronautical Radio, Inc. v. FCC, 642 F.2d 1221 (D.C. Cir., 1980), *cert. denied*, 451 U.S. 920 (1981). In that Decision, the Commission found that it was:

> [u]nable to find that the TELPAK offering, as presently structured, constitutes a proper response to the extent of competition posed by private microwave. We nevertheless believe that a properly structured bulk rate offering, which would compete with private microwave or other competitive alternatives is justified. However, it is clear from the record herein, that the *nationwide* rate differential existing between TELPAK and like private line service cannot be supported by alleged cost comparability between TELPAK and hypothetical private microwave systems.

61 FCC 2d 587, 658 (1976) (emphasis in the original). In response to this finding, the Commission concluded that:

> The rate level differential existing between TELPAK and other private line services constitutes an unlawful discrimination between like services under Section 202(a). We do recognize, however, the benefit to

> industrial, transportation and government users from a bulk offering. Bell may file within the eight month period outlined below a new appropriately responsive bulk offering consistent with our guidelines herein, which can be supported on the basis of competitive necessity, costs, or other relevant factors.

Id. at 659. In response to this directive, AT&T filed tariff changes to eliminate the Transmittal No. 12714 TELPAK (Series 5000) offering. On reconsideration of the Final Decision in Docket No. 18128, the Commission decided that:

> [c]onfusion on the [scope of the Notice of questions at issue] may have resulted from differing statements contained in orders issued during this somewhat convoluted and protracted proceeding. We shall on this ground reconsider the matter of TELPAK's lawfulness as well as whether the return levels on these discounted rates fall within the zone of reasonableness.
>
> * * * *
>
> Consequently, we set aside, and accordingly stay our Order requiring Bell to eliminate TELPAK by June 8, 1977 . . . and will conduct an expedited hearing on the question of TELPAK's lawfulness in general under Sections 201(b) and 202(a) of the Act.

64 FCC 2d 971, 985 (1977).

In addition, the Commission stated:

> [i]n conclusion, on reconsideration we find that the TELPAK discounts, now subject to termination at the carrier's option, have not yet been justified on the basis of either a cost differential, an overall return level, or competitive necessity. Such justification will be the subject of the further hearings we are ordering herein.

Id. at 989. On June 2, 1977, the Commission issued an Order denying petitions to suspend or reject AT&T's

tariff filing terminating the TELPAK offering. In the Matter of American Telephone And Telegraph Company Long Lines Department Revisions To FCC Tariffs No. 258 and 260 (series 5000) Termination of TELPAK Service, 64 FCC 2d 959, 968 (1977). On July 21, 1977, the United States Court of Appeals for the District of Columbia Circuit enjoined AT&T from discontinuing the TELPAK offering to existing customers pending review of the Commission's Order allowing the terminating tariff to take effect. Those TELPAK rates remained in effect through the period under consideration here.

8. Thus, the Commission had not only found specific AT&T tariffs that were in effect during 1978 to have been unlawful, but the Commission had also imposed accounting orders with respect to interstate services that were being provided by AT&T. To the extent that services with associated charges that have been found to be unlawful have been provided through common plant with other services at charges that have not been found to be "just and reasonable", we confront a situation that, in the absence of an upper bound to the carriers earnings, would potentially permit unlimited rates of return on regulated services. We do not believe that Congress intended such a result. Nor do we believe that such a consequence would be consistent with Section 1 of the Communications Act of 1934 or the obligations that are imposed under Sections 201-205 of the Communications Act.

APPENDIX C

FCC 85-284
35867

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

CC Docket No. 79-187

IN THE MATTER OF
AT&T EARNINGS ON INTERSTATE AND FOREIGN SERVICES
DURING 1978

MEMORANDUM OPINION AND ORDER

Adopted: May 29, 1985 Released: May 30, 1985

By the Commission:

1. On December 11, 1984, we issued a *Restitution Decision* [1] in CC Docket No. 79-187 that: (1) concluded that AT&T and the Bell Operating Companies "BCCs" had received $101,000,000 in excess interstate revenues during 1978; [2] (2) imposed a restitution obligation consisting of $101,000,000 plus accrued interest (hereinafter, "restitution obligation"); [3] (3) tentatively divided that restitution obligation in a manner analogous to the apportionment of contingent liabilities in the Bell System Plan of Reorganization approved by the U.S. District

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[1] *In the Matter of AT&T Earnings on Interstate and Foreign Services During 1978* (CC Docket No. 78-187), FCC 84-567 (December 11, 1984) ["*Restitution Decision*"], 49 Fed. Reg. 49502 (December 20, 1984).

[2] *Id.* at para. 15.

[3] *Id.* at paras. 16-19.

Court as part of the antitrust settlement in *United States v. AT&T;*[4] and (4) provided that restitution would be effected through reductions in revenue requirements that were to be reflected in tariffs for interstate services that would be filed during the spring of 1985.[5] Eight petitions for reconsideration have been filed that collectively seek a re-examination of many of the major conclusions that were contained in our *Restitution Decision.*[6] In this *Reconsideration Order* we: (1) reaffirm

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[4] *Id.* at para. 19, n.28.

[5] *Id.* at para. 19.

[6] *Petition for Reconsideration* filed by the American Telephone and Telegraph Company on January 22, 1985 (*"AT&T Petition"*); *AT&T's Response to Petitions for Reconsideration* filed on March 1, 1985 (*"AT&T Response"*); *Petition for Reconsideration* filed by the Bell Atlantic Telephone Companies (Bell Telephone of Pennsylvania, the Chesapeake and Potomac Telephone Companies, the Diamond State Telephone Company, and the New Jersey Bell Telephone Company) on January 22, 1985 (*"Bell Atlantic Petition"*); *Request for Clarification and Contingent Petition for Reconsideration in* CC Docket Nos. 78-72 and 80-286 filed by the GTE Service Corporation and the GTE domestic operating companies (General Telephone Company of California, General Telephone of Florida, General Telephone Company of Kentucky, General Telephone Company of the Southeast, Hawaiian Telephone Company, Bethel and Mt. Aetna Telephone & Telegraph Company, General Telephone Company of Illinois, General Telephone Company of Indiana, Inc., General Telephone Company of Michigan, General Telephone Company of the Midwest, General Telephone Company of Ohio, General Telephone Company of Pennsylvania, General Telephone Company of Wisconsin, General Telephone Company of Alaska, General Telephone Company of the Northwest, Inc., West Coast Telephone Company of California, and GTE Satellite Corporation) (collectively, "GTE") on January 22, 1985 (*"GTE Request for Clarification"*); *Petition for Reconsideration* filed by Nevada Bell Telephone, New England Telephone and Telegraph Company, New York Telephone Company, Pacific Bell Telephone Company, South Central Bell Telephone Company, Southern Bell Telephone and Telegraph Company, Southwestern Bell Telephone Company (collectively termed "BCR Attachment A Companies") on January 22, 1985 (*"BCR Petition"*); *Petition for Reconsideration* filed by the Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Com-

those portions of our *Restitution Decision* that apply to MT&T and the BOCs (hereinafter collectively referred to as "AT&T" unless the context indicates otherwise); and (2) modify certain portions of the *Restitution Decision* that apply to non-AT&T companies so as to relieve those companies from any participation in the restitution obligation.

I. BACKGROUND

2. During the summer and fall of 1978, the Common Carrier Bureau conducted an informal investigation of AT&T's interstate earnings.[7] At that time, it appeared that AT&T had exceeded, and most probably would exceed for calendar year 1978, the rate of return limit of

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pany, and Pacific Northwest Bell Telephone Company (hereinafter, "U.S. West") on January 22, 1985 (*"U.S. West Petition"*); *Petition for Reconsideration of the Rural Telephone Coalition* filed on January 22, 1985 (*"RTC Petition"*); *Petition for Reconsideration* filed by Satellite Business Systems on January 22, 1985 (*"SBS Petition"*); and *Petition for Reconsideration* filed by the United States Telephone Association on January 22, 1985 (*"USTA Petition"*). We also grant herewith the "Motion for Consolidation" filed by The National Telephone Cooperative Association and the Organization for the Protection and Advancement of Small Telephone Companies on May 16, 1985. To the extent stated herein, we also grant: GTE's "Request For Clarification and Contingent Petition For Reconsideration"; incorporate in the record of this proceeding its "CAVEAT"; and rule upon GTE's "Motion for Clarification of Issues and Procedures and For Supplementation of the Record" that was filed out of time, as well as "USTA's Petition For Clarification" that was filed on May 20, 1985.

[7] Authorization for such investigations is contained, *inter alia*, in Sections 0.91 and 0.291 of the Commission's Rules, 47 C.F.R. §§ 0.91 and 0.291 (1978). *See* Sections 4(i)-(j), 5(d), 201-205, 208, and 218 of the Communications Act of 1934, 47 U.S.C. §§ 154(i)-(j) 155(d), 201-205, 208, and 218 (1978). Under prior Commission orders, AT&T was precluded from earning more than a 10.0 percent rate of return. *See AT&T Initial Decision*, 57 FCC 2d 979, 1004-05 (1975); *AT&T Decision* 960, 973 (1976), Sections 205(a) and 408 of the Communications Act of 1934, 47 U.S.C. §§ 205(a), 408 (1978).

10% that had been ordered in Docket No. 20376.[8] On December 20, 1978, the General Services Administration ("GSA") filed a "Petition for Order to Show Cause," (hereinafter, "GSA Petition") which stated that AT&T's earned rate of return exceeded the allowed rate of return, and requested that this Commission require "AT&T to show cause why the Commission should not instruct AT&T to revise its rates and charges for interstate and foreign services to conform to the levels authorized in Docket 20376 . . . ." [9]

3. After receiving the GSA petition, the Acting Chief of the Common Carrier Bureau formally initiated an investigation into AT&T's interstate earnings during 1978 by requesting, by letter dated December 20, 1978, certain information from AT&T concerning those earnings ("December 20 Bureau Letter").[10] On January 22, 1979, AT&T issued the Interstate Monthly Report No. 1 for December 1978 ("December 1978 IMR1"), that showed that its earned rate of return on the interstate operations for 1978 was 10.22%. Subsequent inquiries and correspondence ensued,[11] and on September 19, 1979, the Commission adopted a Notice of Inquiry that sought comments on the policy issues associated with the enforcement of rate of return prescriptions, data that had been filed by AT&T with respect to the measurement of its 1978 interstate earnings, and the mechanisms that should be adopted in effecting restitution.[12]

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[8] *See AT&T Initial Decision, supra,* at 1004-05; *AT&T Decision, supra,* at 973.

[9] *GSA Petition* at 1-4.

[10] Letter from the Acting Chief, Common Carrier Bureau, to Mr. William R. Stump, Assistant Vice President, AT&T, dated December 20, 1978. *See* para. 2, n.7, *supra,* and Section 412 of the Communications Act, 47 U.S.C. § 412 (1978).

[11] *See generally Restitution Decision* at paras. 2-4 and nn.4-9.

[12] *Common Carrier—Interstate and Foreign Earnings* (CC Docket No. 79-187), 75 FCC 2d 412, 413-20 (1979) (*"Notice"*).

4. After receiving comments on alternative restitution mechanisms, a number of changes occurred in the telecommunications industry affecting the methods that had historically been used to compensate exchange and interchange carriers for the use of their facilities in interstate services, including the divestiture of the BOCs from AT&T, the development of access charges, and the formation of the National Exchange Carrier Association ("NECA").[13] Although our *Restitution Decision* took those additional factors into account,[14] we nevertheless sought comment on whether the division of the restitution obligation was correct,[15] and whether the implementing tariffs were "just and reasonable" within the meaning of Section 201(b) of the Communications Act.[16] The petitions for reconsideration that are before us request

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[13] *See United States v,. American Tel. and Tel. Co.*, 532 F.Supp. 131 (1982), *United States v. Western Elec. Co., Inc.*, 569 F. Supp. 1057 (1983); *MTS and WATS Market Structure*, CC Docket No. 78-72, Phase I, 93 FCC 2d 241 (1983) *modified on reconsideration*, FCC 83-536, 48 Fed. Reg. 10319, 54 RR2dd 615 (released on August 22, 1983), *further modified on reconsideration*, FCC 84-36, 49 Fed. Reg. 7810, 55 RR2d 785 (released February 15, 1984) FCC 85-149, —— Fed. Reg. ——, (released April 23, 1985), *aff'd in principal part, Nat'l Ass'n of Regulatory Comm'rs v. FCC* (*"NARDC v. FCC"*), 737 F.2d 1095 (D.C. Cir. 1984), *cert. denied*, 53 U.S.L.W. 3593 (February 19, 1985).

[14] *Restitution Decision* at paras. 17-19.

[15] The *Restitution Decision* apportioned the restitution obligation into an AT&T component and an exchange carrier component, calculated on the basis of the Bell System Plan of Reorganization's contingent liability provisions. *Id.* at paras. 17-19 n.25, paras. 25, 28. *See In the Matter of AT&T's Earnings on Interstate and Foreign Services During 1978* (CC Docket No. 79-187) *Order Denying Requests for Stay*, FCC 85-240 (released May 10, 1985) at para. 4, n.9 and paras. 7-9, (*"Order Denying Requests for Stay"*).

[16] The *Restitution Decision* required prospective reductions in AT&T's interstate rates and exchange carrier rates for access services (through a reduction in the carrier common line rate filed by the National Exchange Carrier Association). *Restitution Decision* at para. 19 n. 28. *See* Section 201(b) of the Communications Act, 47 U.S.C. § 201(b) (1984).

that we modify the *Restitution Decision* on various factual, legal, and policy grounds.

II. DISCUSSION

A. *Factual Issues*

5. The *Restitution Decision* concluded that the 10.22% interstate earned rate of return measurement that was contained in AT&T's December 1978 IMR I would form the basis for calculating the restitution obligations of AT&T and the BOCs.[17] Several petitioners [18] request that we reconsider that portion of our *Restitution Decision*, and, by implication, conclude that a downward adjustment should be made to the 10.22% figure to take into account lower returns on certain interstate services that were purportedly not included in the 10.22% IMR 1 measurement.[19]

6. None of the petitions raise any issues in this regard that were not addressed in the *Restitution Decision*.[20] Nevertheless, in the interest of additional clarity, we shall set forth our reasons for rejecting the inconstant, con-

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[17] *Restitution Decision* at paras. 11-15.

[18] *AT&T Petition* at 19, 22; *BCR Petition* at 7-8; *Bell Atlantic Petition* at 2; *USTA Petition* at 6-7.

[19] *Id.*

[20] The only quantitative information in this proceeding that purports to measure the interstate revenues, expenses, and rate base allegedly associated with the provision of additional interstate services that were not reflected in the IMR 1 rate of return of 10.22% was provided by AT&T in the form of its "1978 FDC Report." Our discussion accordingly centers upon the probative value and credibility that were assigned to that report. Of the three remaining measurements (*see Restitution Decision, supra*, at para. 15, n.19), two measurements (*e.g.*, 9.89%, 10.02%) were rejected on the basis of a distorted, and incorrect, application of our Interest During Construction decisions. The remaining measurement (10.22%) formed the basis for the restitution obligation. *See Restitution Decision, supra*, at para. 11, nn.13-14, paras. 12-15, and Appendix A.

flicting measurements of AT&T's 1978 interstate earnings offered by AT&T as alternatives to 10.22%.[21] For this purpose, it will be useful to develop here the chronology and content of the representations that relate to AT&T's 1978's interstate earnings.[22]

7. The December 20 Bureau Letter, *supra*, informed AT&T that, in the Bureau's view, the rate of return prescription was being violated by the Bell System and asked AT&T to provide certain information concerning its interstate earnings.[23] AT&T, by letter dated January 19, 1979, stated that its 1978 interstate earnings were 10.02% ("January 19 AT&T Letter,"). On January 22, 1979, AT&T issued its December 1978 IMR 1, that showed a cumulative interstate earned rate of return of 10.22% for the calendar year ending December 31, 1978.[24] On April 20, 1979, the Chief of the Common Carrier Bureau requested that AT&T explain "the numerical discrepancy between the 10.22% earned rate of return for 1978 which was contained in the Interstate Monthly Report No. 1 and the earned rate of return of 10.02% for 1978 which was contained in your letter of January 19, 1979." On May 3, 1979, AT&T stated that the discrepancy between the two numbers (*viz.*, 10.02%, 10.22%) could be explained on the basis of Interest During Construction ("IDC") adjustments ("May 30 AT&T Letter"). On June 29, 1979, AT&T filed a "1978 Annual FDC Report", that, *inter alia*, showed an earned interstate rate of return of 10.1%. On July 25, 1979, AT&T

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[21] *Restitution Decision, supra*, at paras. 3-15, Appendices A & B.

[22] Unless otherwise noted, all statements are based upon correspondence between Mr. William R. Stump, AT&T Assistant Vice-President, and the Acting Chief, or Chief, of the Common Carrier Bureau.

[23] *See AT&T Initial Decision, supra*, at 1004-05 (1975); *AT&T Decision* 960, 973 (1976); and para. 8 n.31, *supra*.

[24] On March 8, 1976, AT&T filed a petition seeking increases in its authorized rate of return. *See generally Restitution Decision* at para. 20 and n.33.

confirmed its "position regarding the interstate rate of return for 1978" ("July 25 AT&T Letter"). In relevant part, that letter stated: [25]

> AT&T reports monthly to the Commission the interstate rate of return consistent with the Commission's past decisions as to the appropriate elements of revenues, expenses, taxes and net investment to be used in the calculation of the rate of return. *The report on which the interstate rate of return is shown is the Interstate Monthly Report No. 1.*
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> *The December 1978 Interstate Monthly Report No. 1 showed the interstate rate of return for 1978 to be 10.22%*. This calculation was based on partial compliance with the directives of the Commission in Docket No. 19129 (Phase II) in that certain changes to the elements of revenues and net investment were not to be put into effect until the accounting changes made to Part 31 of the Commission's Rules were effective. As [Mr. Stump] noted in [his] January 19, 1979 response to [the Acting Chief's] December 20, 1978 letter, the going level of the interstate rate of return for 1978 based on full compliance with Docket No. 19129 (Phase II) was 10.02%. . . .
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> In response to [the question that was raised by the Common Carrier Bureau] *the rate of return of 10.22% shown on the December 1978 Interstate Monthly Report No. 1 is the rate of return for 1978* based on the Commission's directives appropriate to that year, including the December 21 decision mentioned above.[26]

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[25] On July 20, 1979, the National Citizens Committee for Broadcasting, the Consumer Federation of America and the Missouri Public Interest Research Group (collectively, "NCCB") filed a petition that sought to have the Commision determine the extent to which "the legally allowed rate of return" had been exceeded.

[26] July 25 AT&T Letter (emphasis added).

On October 26, 1979, AT&T responded[27] to a further staff request for information, in pertinent part, as follows:

> [P]ursuant to your request, we have computed the revenues that would have been required to achieve an after-tax rate of return of 10.0% for the year 1978. The data utilized in the attached analysis indicates that the revenues required to achieve a 10.0% return would have been $101.0 million less than the revenues shown on the Interstate Monthly Report No. 1 for the year 1978 as issued by AT&T on January 22, 1979.

Finally, in comments that were filed on November 13, 1979, in response to the *Notice*,[28] AT&T contended, variously, that other measurements (*viz.*, 9.89% 10.02%, 10.1%) might be more appropriate, depending "upon the purpose of the Commission's review." [29]

8. USTA contends that our decision to use the 10.22% measurement was "wholly arbitrary." [30] The BCR Attachment A Companies assert that the 10.22% figure "does not represent AT&T's actual earnings." [31] AT&T

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[27] Letter from Mr. Thomas E. Lawrence, AT&T, to Mr. Glenn deChabert, Common Carrier Bureau, dated October 26, 1979 ("October 26 AT&T Letter").

[28] *Notice, supra* at para. 3 n. 12.

[29] AT&T Comments in CC Docket No. 79-187 at paras. 60-64 (filed November 13, 1979). At para. 64, n.*, after describing the amount of revenues in excess of 10% that would be received under the alternative measurements, AT&T stated that "[t]his figure represents only Bell Revenues and does not include the effect on Independent Companies concurring in AT&T's interstate tariffs which presumably would also be included in any refunds ordered by the Commission." In a later section of this Memorandum Opinion and Order, we address those aspects of 1978's interstate operations that pertain uniquely to the Independent telephone companies.

[30] *USTA Petition* at 6-7.

[31] *BCR Petition* at 6.

contends that the rejection of the 10.1% (or 10.09%, or, in its more recent reconsideration petition, 10.0859%) measurement that was contained in AT&T's "1978 Annual FDC Report" is erroneous, and that this Commission should not utilize the 10.22% measurement that AT&T supplied.[32]

9. Basically, in these various arguments, petitioners ask us to reconsider our choice among the conflicting numbers that were provided by AT&T with respect to its 1978 interstate earnings. In the *Restitution Decision*, we considered the five different interstate earned rate of return measurements that AT&T had provided, rejected four of those measurements (10.1%, 10.09%, 10.02%, 9.89%),[33] and concluded that the remaining measurement of record in this proceeding (10.22%) would form the basis for the restitution obligation of those carriers that were bound by AT&T's 1978 tariffs and AT&T's representations with respect to 1978 interstate earnings.[34] At the outset, we note that the four rejected measurements were all based upon "adjustments" to AT&T's December 1978 IMR No. 1 that were provided after AT&T had formally been placed on notice[35] that it was in violation

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[32] *AT&T Petition* at 18-25. The 10.1% and 10.09% measurements were contained in AT&T's Comments in CC Docket No. 79-187 at 40-44 (filed November 13, 1979).

[33] *Restitution Decision* at paras. 10-11.

[34] *Id.* para. 15.

[35] *See* December 20 Bureau Letter, *supra*:

"This letter is addressed to the Bell System's rate of return. The most recent financial data reported and our calculations indicate that the Bell System rate of return from interstate and foreign operations presently exceeds the 9.5 to 10.0 percent range prescribed by the Commission in its Docket 20376 Decision in 1976. For the 9-month period ending September 30, 1978, Bell System interstate monthly reports show a cumulative rate of return of 10.42 percent. Even if this figure should be adjusted downward to account for substantial implementation of the Docket No. 19129, Phase II Decision, 64 FCC 2d 1

of the Docket No. 20376 prescription orders. The measurements that were rejected in the *Restitution Decision* were not based upon actual, complete data that were applicable to the calendar year ending December 31, 1978. Because no petitioner sought to contest substantively our rejection of two measurements (*viz.*, 10.02%, 9.89%) that were based upon AT&T's profferred "IDC" adjustments,[36] the only remaining issue is whether we correctly rejected the "FDC 7" measurements that AT&T provided.[37]

10. AT&T contends in its Petition that we "ignored" its "recast" December 1978 IMR No. 1 data (*e.g.*, the AT&T FDC 7 measurements), and that we "adopted a measure" that we "knew to be incomplete."[38] Those

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(1977), the cumulative rate of return yield, according to our calculation, is in excess of 10.1 percent for that time period. Projecting the continued improvement in earnings observed during the past several months, it appears that this figure is likely to increase even more; and perhaps substantially so.

We are presently convinced, therefore, that the Bell System is currently in violation of the Commission's prescription Order in Docket No. 20376. There is no apparent reason to believe that this situation will necessarily be corrected naturally by current or future market conditions; or, that the Bell System is considering decreases in rates or other remedial actions. Of course, the staff is required to interpret, and the Bell System is bound to comply with, the Commission's 1976 rate of return prescription until such time as the Commission may modify its Order . . . ."

[36] *See Restitution Decision* at para. 11, n.14, and Appendix A. AT&T's Petition contains the additional measurement of 10.0859%, which with the IDC decrement of 0.20% would become 9.8859%. For the reasons that are discussed herein and in the *Restitution Decision*, we also reject those measurements.

[37] *See Restitution Decision* at paras. 12-14.

[38] AT&T Petition at 24. Othher petitions raise the same point. Our discussion here of AT&T's contentions also addresses related issues that were raised by other petitioners.

statements are not correct.[39] The *Restitution Decision* did not "ignore" AT&T's "recast" data,[40] but expressed our considered opinion that AT&T's "recast" data should be accorded no weight.[41] Our reasons for this assessment are based principally on defects in the methodologies that AT&T has employed in developing its alternative measurements, as well as on express representations by AT&T that 10.22% accurately stated its interstate rate of return. On June 29, 1979, AT&T filed its "1978 Annual FDC Report." That report, which was based upon data for the month of June 1978, purported to show the rate of return that AT&T had earned during the 1978 calendar year on its interstate services. The "recast" data included interstate investment, expenses, and revenues that had purportedly not been included in the prior IMR 1 reports that AT&T had supplied to this Commission. Specifically, AT&T stated that the IMR 1 did not include investment, revenues, or expenses that were incident to the provision of interstate services at "non-uniform" rates.

11. In the *Notice* in this proceeding, we sought comment upon AT&T's recast of its December 1978 IMR No. 1 conclusions, after noting: (1) that AT&T's 1978 Annual FDC Report had employed cost allocations that had not been approved by the Commission;[42] and (2) that we had theretofore expressed our concerns with respect to AT&T's implementation of the costing methodology that we had adopted in Docket No. 18128.[43]

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[39] *See Restitution Decision* at para. 12.

[40] We requested public comment on those data in the *Notice of Inquiry*. *See Common Carrier Interstate and Foreign Earnings* (CC Docket No. 79-187), 75 FCC 2d 412, 413-14, 418-20 (1979).

[41] *Restitution Decision* at para. 15, n.19.

[42] *Notice* at 413-14, 418-20 (1979).

[43] *See id.* at 414. The Docket No. 18128 costing methodology was to form the basis for the annual cost of service report that AT&T was to file with this Commission.

None of the parties filing comments in response to the *Notice* attempted to perform any sort of quantitative analysis that would have supported the use of AT&T's "1978 Annual FDC Report" as the basis for measuring AT&T's earned interstate rate of return during 1978. Even AT&T's comments, which were in very large measure directed to other reasons why this Commission should not attempt to effect restitution, did not attempt to defend AT&T's 1978 Annual FDC Report from the critical perspectives that had been identified in the *Notice*. In the *Restitution Decision*, we noted that AT&T's *post hoc* "recast" was not based upon data for the entire calendar year, and that the manner in which data was "annualized," was not credible.[44]

12. In addition, our *Restitution Decision* recited statements that had been made by AT&T that expressly stated that 10.22% was the correct measurement.[45] In its January 19, April 20, and May 30 letters, AT&T did not state, or otherwise give any indication, that services were being provided at non-uniform rates that would require a 0.10% decrement from the earned rate of return that AT&T had reported on its IMR No. 1. Instead, AT&T contended that: (1) Interest During Construction required a downward adjustment of 0.20% to the rate of return reflected in the December 1978 IMR 1 Report;[46] and (2) changed economic and financial conditions required a higher rate of return.[47] On May 31, 1979, the Commission held a public meeting that dis-

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[44] *Restitution Decision* at para. 12, and nn.15-17.

[45] AT&T asserts that the scope of the 1975 and 1976 Docket No. 20376 prescription orders were not confined exclusively to services that were provided at "uniform" rates. *AT&T Petition* at 18-24.

[46] *See Restitution Decision* at para. 11, n.14 and Appendix A.

[47] *See id.* at para. 20 and nn.33-34 and AT&T Petition for Determination of a Fair Rate of Return (filed March 8, 1979), CC Docket No. 79-63.

cussed AT&T's earnings measurements and the possibility of refunds. Thereafter, on June 29, 1979, AT&T filed a "1978 Annual FDC Report" that purported to show an interstate rate of return of 10.1% for the calendar year ending December 31, 1978.

13. After the FDC Report had been filed and in response to specific questions that were raised by the Common Carrier Bureau with respect to the inconsistent data that had been received, AT&T stated:

> [Your staff] earlier this week asked us to confirm in writing our position regarding the interstate rate of return for 1978.
>
> AT&T reports monthly to the Commission the interstate rate of return consistent with the Commission's past decisions. . . . The report on which the interstate rate of return is shown is the interstate Monthly Report No. 1. The December 1978 Interstate Monthly Report No. 1 showed the interstate rate of return for 1978 to be 10.22%. . . .
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> * * * *
>
> [T]he rate of return of 10.22% shown on the December 1978 Interstate Monthly Report No. 1 is the rate of return for 1978 based on the Commission's directives appropriate to that year. . . .

On September 27, 1979, the following question was propounded to AT&T:

> Please state: (1) what total revenues for 1979 would have been required to achieve an after tax rate of return of 10.00% and (2) the income tax rates (federal, state, and, if applicable, municipal) which have been applied *to any revenues which have resulted in earnings in excess of the 10.00% rate of return specified in Docket No. 20376.*[48]

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[48] Letter from Mr. Glenn deChabert, F.C.C. Common Carrier Bureau, to Mr. Thomas E. Lawrence, AT&T, dated September 27, 1979.

AT&T replied:

> [P]ursuant to your request, we have computed the revenues that would have been required to achieve an after-tax rate of return of 10.0% for the year 1978. The data utilized in the attached analysis indicates that *the revenues required to achieve a 10.0% return would have been $101.0 million less than the revenues shown on the Interstate Monthly Report No. 1 for the year 1978* as issued by AT&T on January 22, 1979.[49]

The preceding recital reaffirms our previous conviction to rely on AT&T's representation in its IMR 1 concerning its interstate rate of return and not to credit subsequent information that is inconsistent with these representations.[50] The information that has been provided during this investigation has been uniquely in the possession and control of AT&T. AT&T developed the IMR No. 1 earnings report, and has presented it to this Commission for a period in excess of twenty-eight years. After formal inquiry issued from the Common Carrier Bureau concerning AT&T's earnings reflected in those reports AT&T: (a) [*sic*] sought to have the Commission award it a rate of return in excess of the rate of return that had been shown on the December 1978 IMR No. 1 Report;[51] (2) sought to introduce "adjustments" to the IMR 1 data in the form of: (a) IDC adjustments ("full compliance with Docket

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[49] Letter from Mr. Thomas E. Lawrence, AT&T, to Mr. Glenn deChabert, F.F.C. Common Carrier Bureau, dated October 26, 1979.

[50] As a matter of public policy, resolving inconsistent information against the party providing that information provides an incentive for parties to be more accurate in their representations to this Commission. *RKO General, Inc. v. FCC*, 670 F.2d 215, 231-36 (D.C. Cir. 1981).

[51] *See* para. 12, n.48, *supra*.

19129 (Phase II) requirements."; *see Restitution Decision* at Appendix A); and (b) *ad hoc* adjustments for interstate services that were provided at "non-uniform" rates during a period when AT&T and the BOCS had been providing interstate telecommunications services under tariffs that we had found to be unsupported and unlawful (*see Restitution Decision* at Appendix B). AT&T's numerous statements as to the scope and content of the IMR No. 1 *and* the amount of interstate revenues by which AT&T and the BOCS had exceeded the upper bound that had been ordered in Docket No. 20376 contradict AT&T's efforts to derogate the IMR No. 1 as the measurement of AT&T's interstate earnings. As a consequence, we deny those requests that seek to have us conclude that the 10.22% figure is not a proper measure of AT&T's interstate rate of return for 1978 and is not binding upon AT&T and the BOCS.

B. *Legal Issues*

14. Several petitioners[52] question the legal premises that are embodied in, or that relate to, the *Restitution Decision*.[53] USTA reasserts its contention that the Communications Act does not comprehend the prescription of rates of return, and that in some sense, the restitution mechanism that we established constitutes retroactive

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[52] AT&T Petition at 1-9; AT&T Response to Petitions For Reconsideration (filed March 1, 1985); Bell Atlantic Petition at 5-7; BCR Petition at 1-6, 11-14; GTE Petition at 6-21; RTC Petition at 1-14; USTA Petition at 1-6; U.S. West Petition at 3-7.

[53] This section of our *Reconsideration Order* addresses only those legal issues that pertain directly to the restitution obligations of AT&T and the BOCs. Those legal issues that are unique to the Independent telephone companies are addressed in the section captioned "Apportionment of the Restitution Obligation," of this decision, *infra*. For the purpose of this *Reconsideration Decision*, an "Independent" telephone company is a non-AT&T/BOC telecommunications exchange common carrier that received interstate revenues that were derived from AT&T/BOC tariffs during 1978.

ratemaking.[54] With respect to both of these contentions, USTA has not offered anything that was not before the Commission at the time we adopted the *Restitution Decision*.[55] First, the ability to prescribe rates of return is

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[54] *USTA Petition* at 4-5. *But see Nader v. FCC*, 520 F.2d 182, 187-204 (D.C. Cir. 1975) ("*Nader*").

[55] *See Restitution Decision* at paras. 21-22, and nn.37-42. Section 205(a) of the Communications act expressly states that the Commission is empowered "to determine and prescribe what will be the just and reasonable charge or the *maximum* or minimum, or maximum and minimum charge or *charges to be thereafter observed, and what classification, regulation, or practice is or will be* just fair and reasonable, to be *thereafter followed*. . . ." 47 U.S.C. § 205(a) (1975) (emphasis supplied). GTE makes arguments (GTE Petition at 6-10), that are somewhat analogous to those of USTA, arguing, *inter alia*, that 205(a) is prospective in effect, which is irrelevant since the *Restitution Decision* involved the enforcement of an outstanding order that was by its terms prospective in effect. *See AT&T Co.* (Docket No. 20376), 57 FCC 2d 960, 973 (1976), *Restitution Decision* at para. 20. GTE further argues, citing *Arizona Grocery*, that "charges once authorized by the Commission remain in effect as the sole lawful rates until new charges are lawfully prescribed. These new charges may relate only to the future, and they may not in any way imply that prior rates were invalid or be set to redress such perceived invalidity." *GTE Petition* at 7. This Commission did not "authorize" the charges that resulted in the excess revenues during 1978. *Restitution Decision* at paras. 21-22 and Appendix B. However, the Commission did prescribe the maximum rate of return that could be received from interstate services. *AT&T Co.* (Docket No. 20376), 57 FCC 2d 960, 973 (1976). GTE's reference to "lawful rates," is both misleading and incorrect. *See Las Cruces TV Cable v. FCC*, 645 F.2d 1041, 1044 (D.C. Cir. 1981) ("In the argot of ratemaking, a "legal" rate is one filed by the regulated firm with the regulatory agency and not held by that agency to be invalid. A 'lawful' rate is a legal rate that the regulatory agency has upheld as valid. *See Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Railway Co.*, 284 U.S. 370, 383-86 . . ."); *Restitution Decision* at para. 21 and Appendix B. *See* Section 1.52 of the Commission Rules, 47 C.F.R. § 1.52 (1984). GTE's statement (GTE Petition at 8) that "[t]he Commission's refund order is also contrary to Section 205 because the adjustment of charges contemplated in the order will presumably occur without

essential to ensuring that rates are, in the aggregate, "just and reasonable." [56] This is particularly true in an environment where fungible plant is used to provide a variety of services simultaneously.[57]

15. Second, it is difficult to comprehend the basis for USTA's contention that our action constitutes "retroactive ratemaking." The cases cited by USTA in its

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hearings" is also inapposite, since the *Restitution Decision* provided for a hearing on the charges that would implement that decision to determine: (1) whether the division of the restitution obligation among carriers was appropriate; and (2) whether the tariffs that incorporated the provisions of the *Restitution Decision* were "just and reasonable." *Restitution Decision* at para. 18, n.25, para. 25; *Order Denying Requests for Stay* (CC Docket No. 79-187), FCC 85-40 at para. 4 n.8 and paras. 7-9. GTE's contention that the Commission's restitution mechanism constitutes "retroactive ratemaking" (*GTE Petition* at 11-14) is not grounded in case law that corresponds with either the facts or circumstances that apply to the *Restitution Decision*. Without unnecessarily belaboring the point, the cases that GTE cites that address "retroactive ratemaking", evolve, in general, from circumstances in which the regulatory body actually set the specific price, or "charge", that was to be paid by the user of the regulated entity's service. As noted earlier, that is not the case here. The other cases cited by GTE involve fact patterns or statutory issues that are readily distinguished from, and therefore not analogous to, the considerations, facts, or procedures that were present in the *Restitution Decision*. The other legal issues that GTE has raised with respect to the Independent telephone companies are discussed in the separate section of this order that discusses the apportionment of the restitution obligation.

[56] *See* Sections 201, 204-205 of the Communications Act of 1934, as amended, 47 U.S. §§ 201, 204-205 (1978).

[57] *See Restitution Decision* at para. 21, n.38; and Appendix B, para. 8; *In the Matter of Investigation of Access and Divestiture Related Tariffs AT&T Communications Private Line Services* (CC Docket No. 83-1145, Phase II, Tariff FCC No. 3 and Tariff FCC No. 6), FCC 84-292, Appendix (released February 14, 1985).

petition and earlier comments[58] that would seem to bear on this point presuppose prices that were either fixed, prescribed, or approved by the regulatory authority. That certainly is not the case here.[59] USTA also states that "the effect of a rate of return 'prescription' has been consistently viewed by the Commission as a bar to a tariff filing designed to produce a rate of return above the 'prescribed' rate, not as a basis for ordering refunds."[60] While USTA is correct in observing that, in the first instance, tariffs are required to be designed to earn the prescribed rate of return, USTA is incorrect in its construction of the prescription orders at issue here. For "targeting" purposes, the prescribed rate of return was not 10 percent, but 9.5%.[61] The clearly

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[58] *See USTA Petition* at 6, n.*; USITA Comments at 3-7, 15-16. (USTA states that it is the successor organization to USITA, and, as such incorporates by reference all statements made by USITA). For example, USTA relies on *T.W.A. v. Civil Aeronautics Board*, 336 U.S. 601 (1949). But that opinion *begins* by stating:

> [T]he question in this case is whether the Civil Aeronautics Board has authority to fix a new mail rate for air carriers and to make it retroactive for a period in which a final rate *previously fixed by the Board* was in effect and unchallenged by the initiation of a mail rate proceeding. . . .

[59] *See Restitution Decision* at para. 21 and nn.37-40, and Appendix B. On pages 13 and 14 of its petition, USTA states that Section 201(a) is not available to the Commission as a vehicle for apportioning carrier restitution obligations. In a recent order in this proceeding, we addressed the substance of USTA's contentions with respect to Section 201(a). *See Order Denying Requests for Stay* (CC Docket No. 79-187), FCC 85-240 at paras. 7-9, and nn.9-11, 16-22 (released May 10, 1985); "GTE's Motion For Clarification of Issues and Procedures And For Supplementation of the Record."

[60] USTA Petition at 5 (footnote omitted). *Compare Las Cruces TV Cable v. FCC*, 645 F.2d 1041, 1043 (1981) (refunds ordered under rates found by the Commission to be other than just and reasonable; *Restitution Decision* at para. 21 and Appendix B.

[61] *AT&T Co.* (Docket No. 20376), 57 FCC 2d, 960, 973 (1976). *See Memorandum Opinion and Order* in Docket No. 20732, 58 FCC 2d 1 (1976).

stated upper bound upon the earnings that were to be derived from interstate tariffs, however, was, not the "target" rate of 9.5%, but rather the 10 percent limit that had been set upon interstate earnings.[62] Rates were to be targeted to *earn* 9.5%. Restitution would not be required as long as interstate earnings did not exceed 10 percent.[63] As the United States Supreme Court stated in the *Arizona Grocery* case: "[t]he carrier acquires no vested right in any income in excess of a reasonable return on its investment."[64] The maximum "reasonable return" upon that interstate investment was 10 percent.[65]

16. Bell Atlantic, the BCR Attachment A Companies, and GTE contend that we may not rely upon sections 205(a) and 4(i) of the Communications Act in effecting restitution.[66] Our earlier orders in this proceeding address those concerns. *See Restitution Decision* at paras. 20-22; *Order Denying Requests for Stay* (CC Docket No. 79-187), *supra*, at paras. 7-11.[67] For most of these con-

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[62] *Id. AT&T Co.* (Docket No. 20376), 57 FCC 2d 979, 1004-05 (1975).

[63] *Id. Compare Arizona Grocery v. Atchinson, Topeka & Santa Fe Railway Co.*, 284 U.S. 370, 373-74 (1931) ("*Arizona Grocery*").

[64] *Arizona Grocery, supra*, at 373.

[65] *AT&T Co.* (Docket No. 20376), 57 FCC 2d 960, 973 (1976).

[66] Bell Atlantic Petition at 5-7; BCR Petition at 3-4; GTE Petition at 14-15.

[67] In this regard, we note that neither GTE nor Bell Atlantic has provided any additional information that was not comprehended in the pleadings that were filed in response to the initial *Notice*. Bell Atlantic's analysis included a section that suggested that its operating telephone companies had achieved interstate rates of return during 1978 that were at variance with the annual rate of return that AT&T reported to this Commission for the calendar year ending December 31, 1978, and therefore that it should be excluded from any part of the restitution obligation. We address this contention in a later section of this Decision. *See* "Apportionment of the Restitution Obligation", *infra*.

cerns, little, if anything, would be gained by restating the reasoning that is contained in those earlier orders. One issue that merits further amplification, however, concerns the requirement of an "opportunity for a hearing" that Bell Atlantic notes is contained in Section 205(a) of the Act.[68] Other petitioners[69] contend in a variety of statutory contexts (*e.g.*, expressly, with respect to Sections 204 and 205; and by implication, with respect to Sections 207-209 of the Communications Act) that one or more additional "hearings" are required before the Commission may effect restitution in the manner provided in the *Restitution Decision.*

17. As noted earlier,[70] the Commission was engaged in an investigation of AT&T's interstate earnings at the time that the GSA Petition was filed.[71] AT&T had actual knowledge, not later than December 20, 1978, that an investigation of its interstate earnings was in progress.[72] In response, AT&T filed the information that is discussed at paras. 3-14, *supra*; and in the *Restitution Decision* at paras. 10-15 and Appendix A. In the *Restitution Decision*, we resolved the conflicting information that AT&T provided during the course of that investigation by finding that AT&T had earned a 10.22% rate of return on interstate services during 1978. *Restitution Decision* at para. 15, n.19. No further hearing was required with respect to that information. *Id.* We did, however, in the *Notice* which was released in 1979, request comments on alternative restitution mechanisms

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[68] Bell Atlantic Petition at 5.

[69] *Id.* at 5-6; AT&T Petition at 1-18; BCR Petition at 11-14; GTE Petition at 6-21; US West at 4-7.

[70] *See* paras. 2-4 and n.7, *supra.*

[71] *Id. See Restitution Decision* at para. 1, n.1; Section 403, 412 of the Communications Act of 1934, 47 U.S.C. § 403, 412 (1978).

[72] Letter from the Acting Chief, Common Carrier Bureau to Mr. William Stump, AT&T, (December 20, 1978).

and the costs of effecting restitution under those, and other, methods.[73] At that time, we also sought comments on several related matters[74] in light of broader policy issues that concerned the inadequacy of the data that AT&T had been providing in its tariff filings, claims that AT&T's telecommunications plant was underdepreciated, and collateral contentions that AT&T had filed during the spring of 1979 asserting that its cost of capital had increased.[75] The comments in response to that *Notice* indicated that the most inexpensive mechanism for effecting restitution was through the vehicle of a temporary discount.[76] However, in light of changes in the telecommunications industry since the *Notice* was issued, we decided in the *Restitution Decision* to seek further comments on the manner in which we had divided the restitution obligation among carriers that had derived revenues from AT&T's tariffs during 1978,[77] and whether the tariffs filed to implement our *Restitution Decision* were "just and reasonable" within the meaning of the Communications Act.[78] Those comments did not suggest, except as far as the Independent telephone companies were concerned,[79] that the division of restitution obligations established in the *Restitution Decision* was, in any material respect, incorrect, or that the tariffs were other than "just and reasonable."[80]

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[73] *Notice*, supra, at 415-16 para. 7.

[74] *See Notice* at paras. 3-8.

[75] AT&T Petition for Determination of Fair Rate of Return filed in Cc Docket No. 79-63 (March 8, 1979). *See AT&T Co.* (Order Designating Hearing), 73 FCC 2d 689 at para. 1, n.3, 690-94 (1979).

[76] *AT&T Comments* at Attachment (filed November 19, 1979).

[77] *Restitution Decision* at paras. 17, 25.

[78] *Id.*

[79] *See* "Apportionment of the Restitution Decision," *infra.*

[80] Under Section 1.773 of the Commission's rules, 47 C.F.R. §§ 1.773 (1984), the public has also been afforded the opportunity to comment upon the tariffs that have been filed and the adequacy of the cost support that is related thereto.

We thus conclude that we have provided an adequate opportunity for interested parties to be heard.[81]

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[81] As the Court stated in *American Telephone and Telegraph Co. v. FCC*:

> [C]ertainly AT&T had a "full opportunity for hearing." It participated in all three rounds of comments, and after the FCC's initial Report, it filed both a petition for reconsideration and replies to comments made by other parties regarding the various petitions for reconsideration. AT&T may not complain that it had anything less than a "full opportunity" to be heard.

572 F.2d 17, 22 (1978). AT&T has contended, as U.S. West and AT&T contend in their reconsideration petitions here, that an additional hearing was required with respect to changed economic and financial circumstances or, in the alternative, that we incorrectly disregarded evidence that AT&T had provided to the effect that economic and financial conditions had changed so drastically between 1976 and 1978 that the Docket No. 20376 prescription orders had lapsed. We rejected those contentions in the *Restitution Decision* at para. 20 and nn.33-35. Economic and financial conditions are never *totally* static. It is thus necessary to look at the range of economic and financial conditions that obtain with respect to the periods that are subject to comparison. The petitioners fail to take into account the entire record that was before us and the Administrative Law Judge, at the time that we ruled on exceptions to the Administrative Law Judge's initial decision in *early* 1976, as well as other information and data that relate to 1978, including AT&T's Petition for Determination of a Fair Rate of Return in CC Docket No. 79-63 and exhibits filed therewith. Without referring to all of the evidence that was before the Commission with respect to the contested time periods here, we simply note that the reported decisions of the Commission establish the fact that aggregate economic and financial conditions, as well as those that pertained particularly to AT&T, were, during 1978, within the range of conditions that we considered in setting the rate of return prescription during January and early February, 1976. *See Initial Decision of Administrative Law Judge Byron E. Harrison* in Docket No. 20376, 57 FCC 2d 979, 981-1005 (1975); *AT&T Decision* in Docket No. 20376, 57 FCC 2d 960, 962-77; *AT&T Decision* in Docket No. 79-63, 86 FCC 2d 211, 234 (1981). Several petitioners allude to the *Comsat* decision, 68 FCC 2d 941, 942, 950 (1978) (*"Comsat"*) as providing *a fortiori* support for the proposition that *AT&T's* cost of capital had changed substantially enough to have vacated the Docket No. 20376 prescription orders. We reject that inference. The linkages between Comsat's cost of capital determination and

18. AT&T also contends that the Commission's consistent policy has not been to treat its determinations of authorized rates of return as ceilings on earnings that cannot be exceeded, but merely as "targets" for future ratemaking. AT&T complains that the Commission had arbitrarily reversed that "policy" without adequate notice.[82] An objective reading of the decisions that AT&T cites does not support AT&T's contentions, particularly when related decisions, and other portions of the cited decisions are considered in context.[83] For example, during 1973 we stated:

AT&T's cost of capital are not, and were not, direct. *See Restitution Decision* at para. 20, nn.30-37 and references cited therein. Comsat's cost of capital revision was predicated upon the application of a risk premium that was considered to have been *invariant with respect to Comsat* under circumstances that were obviously different. *Compare id., Comsat* at 950. The evidence of record in CC Docket No. 79-63 did not support such a conclusion with respect to AT&T. *See AT&T Decision* (Docket No. 79-63), 86 FCC 2d 257, 270 ("The risk premium found for the twenty-year period averaged 5.6 to 5.7 percentage points. Additionally, analysis of a more recent five-year period indicated an average risk premium of 6.5 to 6.6 percentage points.") Nor did we conclude, after trial, that any of the specific measurements that were contained in *AT&T's Petition for Determination of a Fair Rate of Return* in CC Docket No. 79-63 (filed March 8, 1979) were either accurate or otherwise correct. *AT&T Petition for Determination of a Fair Rate of Return* in CC Docket No. 79-63 (filed March 8, 1979). *See AT&T Decision* in Docket No. 79-63, 86 FCC 2d 221-282 (1981). *Compare Comsat,* 68 FCC 2d at 950 (1978). We thus conclude that U.S. West's contention is without merit. *See* U.S. West Petition at 7, n.13.

[82] *AT&T Petition* at 3-9

[83] *See AT&T Co.* (Docket No. 16258), 9 FCC 2d 30, 116 (1967); *In Re Rate Reduction for Interstate Long-distance Telephone Calls,* 21 FCC 2d 654 (1969); AT&T Co. (Docket No. 19129), 38 FCC 2d 213, 226-27, 245 (1972); *AT&T Co.* (Docket No. 20376), 51 FCC 2d 619, 625 (1975); *AT&T Co.* (Docket No. 20376), 57 FCC 2d 960, 960-61 (1976). For example, AT&T's reference to Docket No. 16258, 9 FCC 2d 30, 115-16 (1967), does not refer to the fact that the Commission required a prospective reduction in rates, after having determined that AT&T's interstate earnings had exceeded

> [e]ssentially that range (*e.g.*, our prescription of 8.5-9.0% as the prescribed range) is intended as our criteria for measuring the reasonableness of AT&T's interstate rates and earnings and the need for adjustment therein. Assuming, therefore, that AT&T's rates were reasonably designed to strike a going level of earnings of 8.5%—and we believe this to be a reasonable assumption—our Decision does not prohibit earnings *up to* 9.0%.

AT&T Co. (Docket No. 19129), 42 FCC 2d 293, 300 (1973) (emphasis added). If the concept of a limit to the amount that AT&T could earn on its interstate operations was not sufficiently clear at that point, the United States Court of Appeals for the District of Columbia Circuit stated:

> [W]e would be shirking reality if we did not recognize that the practical effect of the Commission's Phase I order *was to limit prospectively AT&T's rate of return to 8.5%*

Nader v. FCC, 520 F.2d 182, 201 (1975).

The Court further stated:

> [t]herefore, when the Commission ruled that AT&T could earn a return of 8.5% and allowed AT&T to increase its revenues by $145 million to achieve that return, the Commission necessarily must have intended its decision and order to have the prospective

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the allowable rate of return of all of AT&T's interstate services earnings. *AT&T Co.* (Docket No. 16258) at 114, para. 333. In the second decision cited by AT&T, *In Re Rate Reduction for Interstate Long Distance Telephone Service*, 21 FCC 2d 654 (1969), the Commission stated "[i]n view of these uncertainties, the Commission wishes to make clear that the views expressed herein relate to the current situation and cannot be binding under any future changed economic conditions." *Id.* at 656. AT&T's construction of our Docket No. 19129 decision, 38 FCC 2d 213, 226-227, 245 (1972), is also not supported by an objective reading of the portions of that Decision that AT&T cites.

effect of a prescription, thus, limiting the utility to that return.

Id. at 202. The Administrative Law Judge's Initial Decision in Docket No. 20376 with respect to the maximum rate of interstate earnings that AT&T could receive was explicit: "[T]he Presiding Judge is recommending an overall rate of return *not to exceed 10%*." *Initial Decision of Administrative Law Judge Byron E. Harrison in Docket No. 20376*, 57 FCC 2d 979, 1002 (1975) (emphasis added). *See also id.* at 1004-05. And in affirming the Administrative Law Judge's finding as to the rate of return, we stated that AT&T should be permitted "a level or range of interstate earnings *not to exceed* 10%." *AT&T Co. Decision* (Docket 20376), 57 FCC 2d 973. As a consequence, we believe that, contrary to AT&T's assertions, our decision to require AT&T to restore excess revenues was not based upon a novel policy of which AT&T had no notice.

C. *Policy Issues*

1. *Remedies*

19. The *Notice* in this proceeding requested comments on alternative remedies that might be utilized to effect restitution.[84] The discussion of those alternatives in the *Notice* were grounded on our acute concern that the mechanism of effecting restitution could conceivably cost more than the amount subject to restitution. The comments that were filed in response to that *Notice* stated: (1) that crediting excess revenues to AT&T's accumulated depreciation reserve account would entail a variety of evidentiary, accounting, and jurisdictional separations issues that would impede effecting restitution;[85] and (2)

[84] *Notice* at 415-16.

[85] AT&T Comments at 45-46; United States of Consumer Affairs Comments at 6-7 ("USOCA Comments"); Comments of the NCCB at 10-11.

that direct credits to each customer's bill would be more expensive than providing a discount on future services.[86] Our decision in the *Restitution Decision* to employ a temporary discount on future services was based on these views in the record[87] and on our own independent judgment that this mechanism was the least expensive, and most efficient, approach to effecting restitution.[88]

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[86] As the United States Office of Consumer Affairs stated:

> The practical difficulties inherent in attempting to track revenues received from individuals may make [direct refunds] an impractical solution. Indeed, with some over-collections the cost of determining and refunding to each customer the amount the customer overpaid would exceed the amount of the refund.

USOCA Comments at 4-5 (filed November 14, 1979). On the problems that were associated with effecting direct refunds, the NCCB was more explicit, stating that direct refunds were a "practical impossibility." Comments of the NCCB at 12. *See also* Comments of AT&T at Attachment (filed November 13, 1979).

[87] It was these concerns, in part, that led us to avoid relying on the accounting orders that are discussed in Appendix B of the *Restitution Decision* in formulating the restitution mechanism. *See Restitution Decision* at paras. 17-19 and Appendix B. Our decision to employ as part of that mechanism the common NECA tariff filing that is required to be made each year under our rules was also based upon these concerns. *See* Section 69.3 of the Commission's rules, 47 C.F.R. § 69.3 (1984). *See generally*, parts 61 and 69 of the Commission's rules, 47 C.F.R. §§ 61.1-61.193, 69.1-69.610 (1984). Rather than requiring many exchange telephone companies to file individual tariffs reflecting restitution in separately tariffed charges and associated cost support materials, it was more efficient, less expensive, more timely, and administratively less difficult to determine whether restitution had been effected properly in the context of the scheduled filing of the annual NECA tariff revision. *See Restitution Decision* at paras. 17-18, 25 and nn.25-26. *See also* AT&T Comments at 49-50 (filed November 13, 1979).

[88] *See id., Restitution Decision* at paras. 17-19 and notes contained therein. We did not elect to establish one or more funds for consumer representation in light of comments that had been received suggesting that consumer representation funding was only merited if direct restitution to ratepayers could not be effected. *Id.* Furthermore, it is axiomatic that excess revenues that are

20. Moreover, although we expressed concern about the collateral restitution obligations of the Independent telephone companies,[89] we realized that we did not have a record that was sufficient to effect an apportionment of those obligations[90] and that the incidence of the restitution obligation[91] among carriers would have to be separated administratively from the mechanics of effecting restitution,[92] if restitution were to be accomplished in a timely manner. We thus structured a remedy that was carefully designed to effect restitution in an efficient, economical, and fair manner.[93] Two peti-

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received from interstate customers, in violation of FCC orders, belong to the customers from whom they were received. *See id.* We did not, at the time of the *Restitution Decision*, nor do we now, believe that those revenues properly belong to anyone else. While the relief we have ordered provides restitution to current, rather than 1978, interstate ratepayers, we perceive that there is a substantial overlap between these two groups of consumers of interstate services and that this form of relief is more consistent with our restitutionary obligations than directing that funds be paid to spokespersons or organizations purporting to act on these consumers' behalf. As the United States Office of Consumer Affairs ("USOCA") stated: "It is important to remember that what is at stake is money that rightfully belongs to individual consumers." USOCA Comments at 6. Thus, our obligation is, in the first instance, to restore the excess revenues that were received to ratepayers. *Accord*, Comments of USOCA and NCCB. If ratepayers subsequently choose to use the savings from the rate reductions we have ordered to fund consumer representation in ratemaking proceedings, they will, of course, be able to do so.

[89] *See Restitution Decision* at paras. 1, 17, 19, and notes cited therein.

[90] *Id.* at para. 17, n.25; para. 19, n.28; and para. 25.

[91] *Id.* at para. 25.

[92] *Id.* at paras. 17-19 and n.27. *Orders Denying Requests for Stay* in CC Docket No. 79-187, FCC-240, at paras. 7-9 and n.20 (released May 10, 1985).

[93] Public comment on the tariffs that implement the *Restitution Decision* has been sought in the context of this proceeding, as well

tions have requested, however, that we restructure our remedy in a manner that would be more conducive to their respective interests.[94]

21. U.S. West has suggested that exchange carriers be permitted to retain their respective shares of their restitution obligations and apply the amounts thus obtained "as part of the funding of 'lifeline' service."[95] While lifeline programs serve an important public purpose,[96] there is not necessarily a close match between the beneficiaries of such programs and the group of interstate ratepayers from whom the excess revenues were extracted. We see our objective here as, to the extent possible, providing restitution to those interstate ratepayers and not as providing funding for other, ableit [*sic*] worthy, purposes.

22. Satellite Business Systems ("SBS"), an interexchange services competitor of AT&T, contends that by requiring that AT&T "flow through" its restitution obligation to its customers, we are according "an unjustified preferential status to AT&T's subscribers at the expense of [other interexchange common carriers] customers who are equally entitled to benefit from the restitution of

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as in the context of the normal comment cycle that applies under our rules for tariffs. *See Restitution Decision* at para. 25. With the exception of concerns raised by Independent telephone companies about the imposition of restitution obligations on them and certain competitive concerns raised by interexchange carriers other than AT&T, no party has questioned the justness or reasonableness of that portion of the tariffs that have been filed to implement the *Restitution Decision* or the division of the restitution obligation among AT&T and the exchange carriers that are reflected in those tariffs.

[94] U.S. West Petition at 7-8; SBS Petition at 5-8.

[95] U.S. West Petition at 7.

[96] See Section 69.203(f) of the Commission's Rules, Amendments to Part 69, 50 Fed. Reg. 944 (to be codified at 47 C.F.R. § 69.203(f)).

this sum." [97] In essence, SBS objects to that portion of the *Restitution Decision* that requires AT&T to reduce its rates by its share of the total restitution obligation.[98] For competitive reasons, SBS would prefer that we order AT&T to pay its share of the restitution obligation to the NECA, which would then file a further reduction in exchange carrier access tariffs.[99]

23. We have conclude[d] that it would not be appropriate to modify our *Restitution Decision* as suggested by SBS. SBS has not demonstrated that the "retargeting" that would result from SBS's proposed redirection of AT&T's restitution obligation would be more closely aligned with the composition of the 1978 ratepayer body from whom the excess revenues were received.[100] Second, while competition will generally ensure the flow-through of OCC cost savings, it is not clear that a modification to our restitution plan that had the effect of lowering OCC costs, but increasing AT&T's rates (as compared to those

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[97] SBS Petition at 5. *See* SBS Petition at 6-8 ("By flowing through the entire restitution amount to the benefit of AT&T's customers while applying only one portion of this sum to the benefit of OCC subscribers, the Commission has enabled AT&T to propose rate reductions that are not cost-justified and are disproportionate in size to those that might be effected by the OCCs as a result of the restitution.")

[98] SBS Petition at 5.

[99] *Id.* at 7.

[100] In this regard we note that SBS has not provided information as to the composition of subscribers to AT&T's interexchange services during 1978, as contrasted with those of AT&T and the OCCs during the 1985-1986 restitution period. We do know from other OCC and AT&T filings before this Commission that various OCCs were during 1978, and are now, customers of AT&T's interstate, interexchange services. We are also aware that there were OCC subscribers during 1978, which presents the possibility that some of those subscribers may not have used any of AT&T's interstate, interexchange services during 1978, when AT&T received the excess revenues that are the subject of the *Restitution Decision.*

costs and rates under our current plan), would necessarily result in a lowering of rates to OCC customers as SBS implies. Moreover, the refiling of the existing NECA tariffs and cost support materials, as well as AT&T's tariffs, would impose additional burdens upon the Commission, the NECA, AT&T, and the commenting public, as well as result in further delay in effecting restitution, that would not be offset by concommitant benefits to the public.[101]

B. *Apportionment of the Restitution Obligation*

24. In the *Restitution Decision*, we apportioned the total restitution obligation into an AT&T obligation that was imposed as a reduction in AT&T's revenue requirement for interstate services and an exchange carrier obligation that was imposed as a deduction from exchange carrier common line charges ("carrier common line restitution component").[102] We arrived at that initial division because it was clear that the pre-divestiture restitution liability of AT&T and the BOCs was a liability that was joint in nature, derived, as it were, from the interconnected provision of interstate services.[103] It was also clear under the contingent liability provisions of the Plan of Reorganization that AT&T was contractually bound to a share of the restitution obligation that was equal to the proportion that its interstate plant bore, at the moment of divestiture, to the total interstate plant of the pre-divested enterprise.[104] Less clear was

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[101] SBS has not demonstrated that AT&T's competitors would be so adversely affected that the competitive consequences of the *Restitution Decision* would outweigh the advantages to the public of the tariffs that have already been filed. *See* SBS Comments at 1-9.

[102] *Restitution Decision* at para. 19, and n.28.

[103] *Id.* at para. 17.

[104] *See id.* at para. 19, n.28.

the relationship of the Independent telephone companies to a restitution obligation that had been determined on the basis of AT&T/Bell System accounting of 1978 revenues, expenses, and net rate base.[105] Nevertheless, the Independent telephone companies had participated in revenues during 1978 that had been derived from interstate tariffs filed by AT&T that were designed to compensate those companies for the interstate use of their plant for originating, terminating, or otherwise participating in the provision of interstate communications services.[106] It thus followed that *if excess revenues were received by the Independent telephone companies*, as a consequence of tariffs that had been filed by AT&T, restitution was in order.

25. The record in this proceeding is devoid of any evidence that establishes that the Independent telephone companies earned a rate of return that exceeds the ten percent limit that was prescribed for AT&T. None of the comments that were contained in the Petitions for Reconsideration, Petitions for Stay, or comments that were filed in the "Divisions Proceeding" [107] provide information or support for the proposition that the Independent telephone companies should bear any portion of the restitution obligation that was determined for AT&T and the BOCs.[108] We thus conclude that the NECA shall

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[105] *Restitution Decision* at paras. 1, 10-15, 17.

[106] During 1978, AT&T through the settlements process compensated the Independent Telephone companies for the use of their facilities in completing interstate calls.

[107] The "Divisions Proceeding" was established in the *Restitution Decision* at para. 25, and para. 17, n.25. *See Order Denying Requests for Stay, supra*, at paras. 7-9.

[108] In fact, those filings contained representations that the earned rates of return on interstate services of the Independent telephone companies was less than the 10 percent limit that had been set for AT&T and the Bell System Operating Companies. *See* Reply Comments of the National Telephone Cooperative Association and The

not deduct, from the distributive shares of the Independent telephone companies that are calculated pursuant to Part 69 of the Commission's rules, any portion of the restitution obligation that was imposed upon the carrier common line pool as a consequence of the *Restitution Decision*.[109]

26. At the time that we adopted the *Restitution Decision*, we had not afforded the public an opportunity to comment on the division of the restitution obligation among AT&T and the exchange carriers. With the exception of Bell Atlantic, none of the parties in this proceeding has contended that the contingent liability provisions that are applicable to AT&T and the BOCs result in an inappropriate allocation of the respective restitution obligations of those parties. Bell Atlantic contended, however, that the 1978 earned interstate rate of return of the Bell Atlantic Operating Companies was less than 10%, and therefore, perhaps as a matter of equity, it should not be required to assume any portion of the restitution obligation.[110] As we have noted earlier, Bell Atlantic was part of the pre-divestiture Bell System, the entity to which our rate of return prescription and determination of excess interstate earnings in 1978 ap-

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Organization for the Protection and Advancement of Small Telephone Companies at 3-4 (filed May 16, 1985); GTE Petition at 4-6 and Affidavit of William E. Stein. Although USITA participated in the 1975 and 1976 AT&T/Bell System rate of return proceedings, as USITA did in CC Docket No. 79-63, our Docket No. 20376 decisions did not prescribe a separate rate of return limitation upon the interstate operations of the Independent telephone companies. Nor were the costs of capital of the Independent telephone companies expressly at issue in Docket No. 20376. *See AT&T Co.* (Docket No. 20376), 57 FCC 2d 960-73 and references cited therein.

[109] *See Restitution Decision* at para. 19. As a consequence of our decision today, the portion of the restitution obligation to be recovered through reductions in carrier common line charges will be borne entirely by the BOCs.

[110] *Bell Atlantic Petition* at 1-4, Affidavit of Edwin R. Burtner.

plied. We find it appropriate that the restitution obligation be borne by all the pre-divestiture members of the Bell System. Moreover, nothing further would be gained at this point by the initiation of individual or related allocative proceedings with respect to further reapportionments of the respective restitution obligations of AT&T and the 22 BOCs.

27. AT&T and the BOCs are further bound by the allocative representations, under the contingent liabilities provisions of the Plan of Reorganization, that were made by them in the tariffs that were filed at the Commission to implement the *Restitution Decision*. We see no need to promote unnecessary litigation in the United States District Courts among the BOCs and AT&T. As a consequence, we further direct that the NECA shall reduce the distributive shares of the BOCs that [*sic*] are subject to the contingent liability provisions of the Plan of Reorganization by *pro tanto* shares of the carrier common line restitution component [111] that are equal to the amount of each BOC's "relative investment devoted to interstate services as of the effective date of divestiture (as calculated in accordance with the FCC-prescribed Separations Manual in effect on the date of divestiture), adjusted to reflect the assignments of assets under this Plan of Reorganization (CPE and InterLATA assets to AT&T, and intraLATA assets to the BOCs)." [112]

28. In the *Restitution Decision* and in our actions on reconsideration here, it has been necessary to exercise the discretion that the Communications Act confers upon

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[111] *See Order Denying Stay, supra*, at para. 8.

[112] *See id.* at paras. 7-10; "Plan of Reorganization", filed in *United States v. Western Electric Co. & AT&T*, C.A. No. 82-0192 (D.D.C., filed December 16, 1982), at 188. This provision applies to those BOCs that are subject to the Modification of Final Judgment that was the basis for the "Plan of Reorganization."

this Commission. Each case must necessarily be examined on its own merits, with the procedures that are employed and the remedy that is developed being appropriate to the facts and circumstances that are presented.

ORDERING CLAUSES

29. ACCORDINGLY, IT IS ORDERED That the Petitions for Reconsideration ARE GRANTED to the extent stated herein, and are, in all other aspects, DENIED.

30. IT IS FURTHER ORDERED That all other motions or positions that have been filed in this proceeding ARE GRANTED to the extent indicated or referred to herein,[113] and are, in all other respects, DENIED.

31. IT IS FURTHER ORDERED That the Secretary shall, with the exception of the American Telephone and Telegraph Company and the Bell System Operating Companies, transmit a copy of this decision to the National Exchange Carrier Association and to each of the parties filing comments in this proceeding.

32. IT IS FURTHER ORDERED That the Secretary shall, by registered mail, serve a copy of this decision upon the American Telephone and Telegraph Company and each of the Bell Operating Companies in accordance with Sections 416 and 413 of the Communications Act of 1934, as amended, and shall enter proof of such service in the docket in this proceeding.

33. IT IS FURTHER ORDERED that this proceeding is terminated.

FEDERAL COMMUNICATIONS COMMISSION

WILLIAM J. TRICARICO,
Secretary

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[113] In this regard, we incorporate by reference the *Order Denying Requests For Stay* in CC Docket No. 79-187, *supra*.

APPENDIX D

CC
FCC 85-573
36252

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

CC Docket No. 79-187

IN THE MATTER OF
AT&T's EARNINGS ON INTERSTATE AND
FOREIGN SERVICES DURING 1978

MEMORANDUM OPINION AND ORDER AND REQUEST FOR COMMENTS

Adopted: October 24, 1985 Released: October 30, 1985
By the Commission:

I. *Introduction*

1. On July 1, 1985, the Telecommunications Action and Research Center ("TRAC")[1] filed a petition ("TRAC Petition")[2] seeking further reconsideration of our decision (*"Restitution Decision"*) in the above captioned docket.[3] TRAC's petition appears to seek reconsideration

[1] TRAC contends that it stands in the shoes of the National Citizens Committee for Broadcasting ("NCCB"), an organization that filed comments during an earlier phase of this proceeding.

[2] Petition for Reconsideration of Memorandum Opinion and Order filed by TRAC on July 1, 1985 ("TRAC Petition").

[3] *See* generally, In the Matter of AT&T Earnings on Interstate and Foreign Services During 1978 (CC Docket No. 79-187), FCC

on three grounds. First, TRAC requests that we further reconsider our decision not to establish a fund for consumer representation.[4] TRAC appears to contend that statements in our *Reconsideration Order*, which gave a detailed explanation of our decision not to designate a portion of this restitution to fund consumer representation groups,[5] creates a basis by which TRAC may properly seek reconsideration, out of time, of that decision.[6] TRAC also contends that the reduction in the charge per interstate access minute that was required by the *Restitution Decision*'s deduction from the carrier common line pool[7] was improper because: (i) other common carriers ("OCCs") receive interstate exchange access services in addition to AT&T;[8] and (ii) interest on the declining balance was not computed and deducted from interstate revenue requirements by NECA and AT&T for the periods that the tariffs effecting restitution would be in effect.[9]

2. On July 3, 1985, the Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Company, and Pacific Northwest Bell Telephone Company (collectively, "US West") filed a petition for clarification

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84-567 (December 11, 1984) ["*Restitution Decision*"], 49 Fed. Reg. 49502 (December 20, 1984); Memorandum Opinion and Order In the Matter of AT&T Earnings on Interstate and Foreign Services During 1978 (CC Docket No. 79-187), FCC 85-284 (released May 30, 1985) ["*Reconsideration Order*"].

[4] TRAC Petition at 1-2.

[5] *Reconsideration Order* at para. 19, n.88. *See also Reconsideration Order* at paras. 17, 19-23 and notes contained therein.

[6] TRAC petition at 1-2, 4-5.

[7] *Restitution Decision* at para. 19.

[8] TRAC petition at 4.

[9] TRAC petition at 2-3. The *Restitution Decision* required that interest be computed until the tariffs that implemented the *Restitution Decision* were filed with this Commission. *Restitution Decision* at para. 19, n.29.

of the *Reconsideration Order* and the *Order Denying Requests for Stay* in CC Docket No. 79-187, FCC 85-240 (reelased May 10, 1985).[10] US West also filed a "Contingent Motion for Stay."[11] In these petitions, US West seeks in effect: (i) a declaratory ruling that the "revenue requirement reductions currently being implemented in conformance with the [*Restitution Decision*] can be recouped through surcharges to the carrier common line charge or another appropriate mechanism,"[12] or (ii) if the Commission were to conclude that it did not have the authority to order such a surcharge, an order staying the operative provisions of the *Restitution Decision* pending judicial review.[13]

3. Comments on the petitions were filed by the American Telephone and Telegraph Company ("AT&T"), BellSouth Corporation ("BellSouth"), GTE Service Corporation ("GTE'), New York Telephone Company and the New England Telephone and Telegraph Company ("NYNEX"), and the Pacific Bell and Nevada Bell Telephone Companies ("Pacific").[14] Reply comments were

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[10] Petition for Clarification filed by the Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Company, and Pacific Northwest Bell Telephone Company filed on July 3, 1985 (hereinafter "US West Petition for Clarification").

[11] Contingent Motion for Stay filed by US West on July 3, 1985 (hereinafter, "US West Stay Petition").

[12] US West Stay petition at 2.

[13] US West Stay Petition, *passim*.

[14] Opposition of American Telephone and Telegraph Company filed on August 8, 1985 ("AT&T Comments"); Comments in Support of Petition for Clarification filed by BellSouth Corporation on August 8, 1985 ("BellSouth Comments"); Opposition to Petition for Reconsideration filed by GTE Service Corporation and the domestic GTE telephone operating companies on August 8, 1985 ("GTE Comments"); Opposition of NYNEX Telephone Companies to TRAC's petition for Reconsideration filed by NYNEX on August

filed by TRAC and US West.[15] With respect to the TRAC petition, the comments generally contended: (1) that the petition is untimely and repetitious;[16] and (2) that TRAC is seeking reconsideration of the wrong order.[17] With respect to the US West petition, the comments contended: (1) that a surcharge to permit carrier recoupment would not be "retroactive ratemaking";[18] (2) that even if such a surcharge constituted "retroactive ratemaking" it would be permissible because the need for the remedy was grounded in FCC error;[19] (3) that in any event, it would be inequitable for AT&T and the BOCs to be penalized if the FCC were in error.[20] In this Order we dismiss the TRAC and US West petitions, and seek comment on the most efficient method to restore foregone interest to ratepayers on the declining restitution balance.

II. *Discussion*

A. The TRAC Petition

4. TRAC's petition for reconsideration contends that our restitution plan is flawed and that the Commission should effect restitution by creating a fund for consumer groups. In our view, the TRAC petition is an untimely

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8, 1985 ("NYNEX Comments"); Comments in Support of Petition for Clarification filed by Pacific Bell and Nevada on August 8, 1985 ("Pacific Comments"). Response of TRAC to TELCO Petition for Clarification and Contingent Motion for Stay filed by TRAC on August 8, 1985 ("TRAC Response").

[15] Reply to Response of TRAC to Telco Petition for Clarification and Contingent Motion for Stay filed by US West on August 19, 1985 ("US West Reply").

[16] *Id.*

[17] NYNEX comments at 1, 3-10. AT&T comments *passim.*

[18] BellSouth comments at 2-3. *Accord,* Pacific comments at 6-7.

[19] Pacific comments at 3-7, BellSouth comments at 3-4.

[20] Pacific comments at 3-4, BellSouth comments at 2.

attack on the part of the *Restitution Decision* which addressed this issue. The *Restitution Decision* was released on December 11, 1984, and published in the Federal Register on December 20, 1984. TRAC asserts that the *Reconsideration Order* opened the door for its petition by explaining further why we did not adopt a restitution plan that would fund consumer groups.[21] However, the *Reconsideration Order* did not modify any aspect of the *Restitution Decision* with respect to any issue that was raised in the TRAC Petition. That we had rejected the consumer fund option was clear in the *Restitution Decision*, yet TRAC offered no explanation for its failure to raise its arguments in response to that order. Our rules governing reconsideration contemplate our entertaining further reconsideration petitions only to the extent that the original order was modified on reconsideration. *See* 47 C.F.R. § 1.429(i) (1984). Therefore, dismissal of TRAC's petition for further reconsideration, which did not address any of the modifications made on reconsideration, is appropriate under Commission rules.[22]

B. The U.S. West Petitions

5. US West requests that we issue a declaratory ruling that would conclude either: (1) that the Commission is empowered under the Communications Act to take

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[21] *Reconsideration Order*, n.88

[22] As NYNEX accurately stated in its comments:

> TRAC attempts to avoid the untimeliness of its petition by purporting to seek reconsideration of the *Reconsideration Order*. However, TRAC's complaints do not relate to the action taken in the *Reconsideration Order*. Apart from affirming its decisions concerning the refund mechanism applicable to AT&T and the former BOCs, the only action the Commission took in the *Reconsideration Order* was to relieve the independent telephone companies of any restitution obligations. Significantly, TRAC does not seek reconsideration of that action.

NYNEX Comments at 5. *See* AT&T Comments at 2-4, NYNEX comments at 4-8.

such action as may be necessary to repair any damage that US West might experience if the Commission's *Restitution Decision* were determined judicially to be in error; [23] or (2) that if we were to conclude that we did not have the requisite authority, that we stay that portion of the tariff reductions that implement the *Restitution Decision.*[24]

6. We have previously denied petitions that sought to stay the *Restitution Decision.*[25] At that time we noted that we did not perceive that further delay in effecting restitution to ratepayers was either necessary or desirable.[26] Our assessment has not changed. The earlier requests for stay [27] were denied under the criteria [28] that were established in *Virginia Petroleum Jobbers Ass'n v. Federal Power Commission.*[29] *Virginia Petroleum Jobbers* requires, *inter alia,* that a petitioner demonstrate that it is likely to prevail on the merits of its appeal. In this regard, US West states "our legal position is set forth in [US West's] Petition for Reconsideration of the *Restitution Decision.*" [30] We have previously rejected US

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[23] US West Petition for Clarification at 1, 4.

[24] *See id.,* US West Contingent Motion for Stay at 1, 4.

[25] *Order Denying Requests for Stay* in CC Docket No. 79-187, FCC 85-240 at para. 11 (released May 10, 1985).

[26] *Id.* at para. 10.

[27] *See id.* at para. 1, n.2.

[28] *Id.* at paras. 2, 4, 6, 9-11.

[29] *Virginia Petroleum Jobbers Ass'n v. Federal Power Commission,* 259 F.2d 921, 925 (D.C. Cir. 1958) ("*Virginia Petroleum Jobbers*"). *See also Washington Metropolitan Area Transit Commission v. Holiday Tours, Inc.,* 559 F.2d 841, 843 (D.C. Cir. 1977); *Wisconsin Gas Co. v. FERC,* No. 84-1358, slip op. at 15, 18-19 (D.C. Cir. March 29, 1985).

[30] US West Petition at 3.

West's "legal position," [31] and US West has not provided any additional information in its "Contingent Motion for Stay" that would warrant a conclusion that we should alter the determinations that are contained in the *Restitution Decision* or the *Reconsideration Decision.* In addition, US West has also not demonstrated that the issuance of a stay would not substantially harm other parties, or that the public interest would not be harmed by the issuance of a stay—two other criteria for a stay under *Virginia Jobbers.*[32]

7. The last criterion that is specified in the *Virginia Jobbers* opinion (*i.e.*, irreparable harm to the petitioner in the absence of a stay) frames, in more general terms, the issue that US West has elected not to address in its Contingent Motion for Stay, but has instead elected to frame as a question for us in its Petition for Clarification (*i.e.*, whether the Commission has the authority to restore to US West the reduction in US West revenues that is occasioned by the *Restitution Decision*). Even if US West were to have briefed the issue of the Commission's authority (or lack thereof), which it did not,[33] it is neither timely nor otherwise appropriate for us to consider that matter here. An analysis of our remedial authority would have to be considered in the context of an order from the reviewing Court that reversed, in whole or in part, the *Restitution Decision.* The scope and remedial content of such an order, if issued, would also be

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[31] *Reconsideration Order* at paras. 14-33, *Restitution Decision* at paras. 20-22.

[32] *Order Denying Requests for Stay* in CC Docket No. 79-187, *supra* at paras. 9-10.

[33] While it did not brief the issue, US West has apparently concluded that the Commission has the requisite authority. US West Petition For Clarification at 4-5 ("The Commission . . . may permit companies whose revenue requirements were ordered reduced by the Restitution Decision to recover this amount in the event of Court reversal"). *Accord* Bell South comments, *passim.*

based upon the authority of the Court (in addition to the authority that is conferred upon the Commission under the Communications Act) to correct administrative errors. We will not speculate as to whether such an order will issue, or if it were to issue, the content of such an order. We do conclude, however, that US West has not made the threshold showings that are required for the issuance of a stay, and we will deny the request that is contained in US West's petition for clarification.

C. *Interest*

8. In structuring the remedy that is contained in the *Restitution Decision*, we required the National Exchange Carrier Association (on behalf of the Bell Operating Companies) and AT&T to calculate interest on their respective restitution obligations.[34] The computation of interest terminated with the filing of tariffs that implemented that Decision.[35] We tolled the computation of interest at the tariff filing date of several reasons. First, it was necessary that the NECA have a defined obligation, that was certain in amount, that was to be deducted from the carrier common line revenue requirement.[36] The calculation of that sum required that the "end point" for the interest calculation be defined. The end point could not, in advance, be tied to the effective date of the tariffs since, in the absence of public comment and Commission review,[37] it was not possible to determine whether the tariffs that had been filed by the NECA would be in compliance with the *Restitution Decision* and otherwise be in compliance with Title II of the Communications

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[34] *Restiution Decision* at para. 16.

[35] *Id.* at para. 19.

[36] *See id.* at para. 17, n.25, and paras. 24-25.

[37] *See* sections 201-205 of the Communications Act of 1934, as amended, 47 U.S.C. 201-205 (1984). *See also* Part 61 of the Commission's rules, 47 C.F.R. §§ 61.1-61.193 (1984).

Act.[38] Second, AT&T's tariffed charges necessarily had to take correctly into account the tariffed charges of NECA for interstate access that ultimately were to become effective. Further, the effective date of AT&T's tariffs that would be in compliance with the *Restitution Decision* similarly could not be determined in advance in the absence of public comment and Commission review.[39] As a consequence, the procedural requirements that were associated with the tariff review process necessitated, administratively, that dates for the calculation of interest be set independently of the effective dates of the tariffs that implemented the *Restitution Decision.* Since that time, tariffs that implement the *Restitution Decision* have become effective with the consequence that we need to explore the most efficient approach to calculating and restoring to ratepayers interest on the declining balances of the restitution obligations for the periods that the reduced tariffs are in effect. We thus seek comment upon the exact computations that should be made, and the form that the implementing order should take, to restore to ratepayers interest on the declining restitution obligations during the period of the reduced rates. Comments and replies[40] on the aforesaid issues may be filed on or before November 18, 1985, and December 18, 1985, respectively.

9. IT IS ORDERED, That the petitions of TRAC and US West are denied, and that the Secretary shall serve copies of this Order upon AT&T, the Bell Operating Companies, NECA, TRAC, and US West.

FEDERAL COMMUNICATIONS COMMISSION

WILLIAM TRICARICO
Secretary

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[38] *See* nn. 36-37, *supra.*

[39] *See id.*

[40] Comments and reply comments should be captioned "CC Docket 79-187: Computation of Interest."

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 85-1087

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, *et al.*,
Petitioners

v.

FEDERAL COMMUNICATIONS COMMISSION and the UNITED STATES OF AMERICA,
Respondents

GTE SERVICE CORP., *et al.*, NATIONAL TELEPHONE COOPERATIVE ASSOCIATION, *et al.*, AMERICAN TELEPHONE & TELEGRAPH CO., AMERITECH OPERATING CO., MOUNTAIN STATES TELEPHONE & TELEGRAPH CO., *et al.*, SATELLITE BUSINESS SYSTEMS, U.S. TELEPHONE ASSOCIATION, TELECOMMUNICATION RESEARCH & ACTION CENTER, SOUTH CENTRAL BELL TELEPHONE CO., SOUTHWESTERN BELL TELEPHONE CO.,
Intervenors

No. 85-1457

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,
Petitioner

v.

FEDERAL COMMUNICATIONS COMMISSION and the UNITED STATES OF AMERICA,
Respondents

U.S. TELEPHONE ASSOCIATION, GTE SERVICE CORP., *et al.*, MOUNTAIN STATES TELEPHONE & TELEGRAPH CO., *et al.*, BELL OPERATING COMPANIES, SOUTHWESTERN BELL TELEPHONE CO.,
Intervenors

No. 85-1471

THE MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY, *et al.*,
Petitioners

v.

FEDERAL COMMUNICATIONS COMMISSION and the UNITED STATES OF AMERICA,
Respondents

GTE SERVICE CORP., *et al.*, AMERITECH OPERATING CO., AMERICAN TELEPHONE & TELEGRAPH CO., BELL OPERATING COMPANIES, SOUTHWESTERN BELL TELEPHONE CO.,
Intervenors

No. 85-1472

PACIFIC BELL, *et al.*,
Petitioners

v.

FEDERAL COMMUNICATIONS COMMISSION and the UNITED STATES OF AMERICA,
Respondents

GTE SERVICE CORP., *et al.*, MOUNTAIN STATES TELEPHONE & TELEGRAPH CO., *et al.*, AMERITECH OPERATING CO., AMERICAN TELEPHONE & TELEGRAPH CO., BELL OPERATING COMPANIES, SOUTHWESTERN BELL TELEPHONE CO., *Intervenors*

Petitions for Review of Orders of the
Federal Communications Commission

Before: MIKVA and BUCKLEY, Circuit Judges, and PARSONS, *Senior District Judge.

JUDGMENT

These causes came on to be heard on the petitions for review of orders of the Federal Communications Commission, and were argued by counsel. On consideration thereof, it is

ORDERED and ADJUDGED, by this Court, that the petitions for review are hereby denied, in accordance with the Opinion for the Court filed herein this date.

Per Curiam
For The Court

/s/ George A. Fisher
GEORGE A. FISHER
Clerk

Date: August 21, 1987

Opinion for the Court filed by Circuit Judge Mikva.

Dissenting opinion filed by Circuit Judge Buckley.

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* Of the United States District Court for the Northern District of Illinois, sitting by designation pursuant to 28 U.S.C. § 294(d).

APPENDIX F

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 85-1087

NEW ENGLAND TELEPHONE AND
TELEGRAPH COMPANY, *et al.*,
Petitioners

v.

FEDERAL COMMUNICATIONS COMMISSION and the
UNITED STATES OF AMERICA,
Respondents

and consolidated cases

Before: Wald, Chief Judge; Robinson, Mikva, Edwards, Ruth B. Ginsburg*, Starr, Silberman*, Buckley, Williams, D.H. Ginsburg and Sentelle, Circuit Judges

ORDER

Petitioners' Suggestion for Rehearing *En Banc* has been circulated to the full court. The taking of a vote thereon was requested. Thereafter, a majority of the judges of the Court in regular active service did not vote in favor of the suggestion. Upon consideration of the foregoing, it is

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* Circuit Judges Ruth B. Ginsburg and Silberman did not participate in this order.

ORDERED, by the Court *en banc*, that the suggestion is denied.

FOR THE COURT:
CONSTANCE L. DUPRE
Clerk

By: /s/ Robert A. Bonner
ROBERT A. BONNER
Deputy Clerk

A dissenting statement of Circuit Judge Starr, in which Circuit Judges Williams and Buckley join, is attached.

A separate statement of Circuit Judge D. H. Ginsburg is also attached.

A separate statement of Circuit Judge Sentelle is also attached.

STARR, *Circuit Judge*, joined by WILLIAMS and BUCKLEY, *Circuit Judges, dissenting from denial of rehearing en banc*: The fundamental issue presented in these cases is of manifest importance. Not only are the economic stakes staggeringly high, but the FCC has expansively asserted a recently discovered power enshrouded for a half century in the mists of the Communications Act of 1934. This recent discovery at 19th and M Streets represents yet another example in the long and dreary line of bureaucratic excesses in our system of limited government. The FCC has, in brief, purported to exercise a power which Congress never conferred upon it; what is worse, the Commission's clawback approach and mandating of the maximum rate of return do violence to well-settled, salutary doctrines, such as the bar on retroactive ratemaking and the filed rate doctrine. In the process, the Commission's ratemaking revolution flies in the teeth of the twin virtues of stability and predictability which rate regulatory regimes are designed to foster.

The errors complained of are, in short, profound. Unfortunately, as the order denying the suggestion indicates, a number of our judges have not been able to participate in evaluating the merits of what I believe to be a compelling demonstration by Comsat and other telecommunications firms that the *New England* majority was badly wrong. This substantial shortage in judicial personnel has virtually foreordained that this issue cannot now be afforded the *en banc* treatment that it so plainly deserves. Under these circumstances, the state of the law in this circuit on a pivotal statutory issue cutting across agency lines can only be regarded as distressingly unsettled until the question arises in a context where the court can truly turn its full evaluative powers to the question at hand.

Separate Statement of Circuit Judge D. H. Ginsburg: As I was not a member of the panel in either of these cases and, therefore, did not receive the benefit of plenary briefs and oral argument, I am not in a position to speak with the conviction expressed by Judge Starr. I do not doubt, however, that the issues raised by his thoughtful statement warrant examination by the court *en banc*.

Separate Statement of Circuit Judge David B. Sentelle: I do not intend by joining in the vote to deny rehearing *en banc* to imply a position on the merits of *en bancing* this controversy. Rather, it appears to me that a case with multiple recusals is a particularly poor vehicle for re-visiting a recurring question of Circuit law.

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 85-1087

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY,
Petitioners

v.

FEDERAL COMMUNICATIONS COMMISSION and the
UNITED STATES OF AMERICA,
Respondents

and consolidated cases

Before: Mikva and Buckley, Circuit Judges

ORDER

[Filed Nov. 2, 1988]

Upon consideration of petitioners' petition for rehearing, it is

ORDERED, by the Court, that the petition is denied.

FOR THE COURT:

CONSTANCE L. DUPRE

By: /s/ Robert A. Bonner
ROBERT A. BONNER
Deputy Clerk

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA

No. 85-1087

NEW ENGLAND TELEPHONE AND TELEGRAPH CO., *et al.*,
Petitioners

v.

FEDERAL COMMUNICATIONS COMMISSION and the
UNITED STATES OF AMERICA,
Respondents

and consolidated cases

Before: Wald, Chief Judge; Robinson, Mikva, Edwards, Ruth B. Ginsburg *, Starr, Silberman *, Buckley, Williams, D.H. Ginsburg * and Sentelle, Circuit Judges

ORDER

[Filed Nov. 23, 1988]

It is ORDERED, by the Court *en banc*, on its own motion, that the order filed on November 2, 1988, denying petitioners' suggestion for rehearing *en banc* is amended as follows:

(1) The names of the judges are amended by adding an asterisk next to the name of Circuit Judge D.H. Ginsburg as follows:

Before: Wald, Chief Judge; Robinson, Mikva, Edwards, Ruth B. Ginsburg *, Starr, Silberman *, Buckley, Williams, D.H. Ginsburg * and Sentelle, Circuit Judges

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* Circuit Judges Ruth B. Ginsburg, Silberman, and D.H. Ginsburg did not participate in this order.

(2) Insert the name of Circuit Judge D.H. Ginsburg in the fourth sentence from the end of the order, to read as follows:

"* Circuit Judges Ruth B. Ginsburg, Silberman and D.H. Ginsburg did not participate in this order."

(3) Delete the following sentence, in its entirety, from the order:

"A separate statement of Circuit Judge D.H. Ginsburg is also attached."

(4) Delete, in its entirety, the "Separate Statement of Circuit Judge D.H. Ginsburg."

It is FURTHER ORDERED, by the Court *en banc*, that all other aspects of the Court's November 2, 1988 order remain the same.

For the Court:

/s/ Constance L. Dupre
CONSTANCE L. DUPRE
Clerk

APPENDIX G

UNITED STATES COURT OF APPEALS
DISTRICT OF COLUMBIA CIRCUIT

Nos. 85-1778, 85-1805, 85-1807, 86-1216, 86-1234, 86-1255, 86-1322 to 86-1324 and 87-1025

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,
Petitioner

v.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA,
Respondents,

SOUTHWESTERN BELL TELEPHONE COMPANY, GTE SERVICE CORPORATION, AMERITECH OPERATING COMPANY, PUERTO RICO TELEPHONE COMPANY, COMMUNICATIONS SATELLITE CORPORATION, CONTINENTAL TELECOM INC., NEW YORK TELEPHONE AND NEW ENGLAND TELEPHONE COMPANY, BELL-SOUTH CORPORATION, BELL ATLANTIC TELEPHONE COMPANIES, UNITED TELEPHONE SYSTEM, INC., MOUNTAIN STATES TELEPHONE COMPANY, *et al.*, PACIFIC BELL, *et al.*,
Intervenors.

Petitions for Review of Orders of the
Federal Communications Commission

Argued May 21, 1987
Decided Jan. 22, 1988

Before MIKVA, BORK and STARR, Circuit Judges.

Opinion PER CURIAM.

Concurring opinion filed by Circuit Judge STARR.

PER CURIAM:

Petitioners, numerous telephone companies and other carriers of telecommunications services, challenge the adoption of a rule by the Federal Communications Commission (the "Commission") that requires the carriers to refund earnings they receive in excess of the expected rate of return on capital factored into their rates. Petitioners claim that the refund rule is arbitrary and capricious, exceeds the Commission's statutory authority, and is an unconstitutional confiscation of their property. We agree that the refund rule is arbitrary and capricious and grant the petitions for review.

I.

Under the Communications Act of 1934, ch. 652, 48 Stat. 1064 (codified as amended at 47 U.S.C. §§ 151-611 (1982 & Supp. II 1985)) (the "Act"), the Commission regulates the rates a carrier may charge for interstate telecommunications service. 47 U.S.C. §§ 201-205 (1982). As part of that task, the Commission sets the rate of return on capital that the carrier may use in setting its rates. *See, e.g., Nader v. FCC*, 520 F.2d 182, 191-92 (D.C. Cir.1975); *AT & T*, 86 F.C.C.2d 221, 223 (1981). The carrier then calculates its rates so that projected revenues will cover projected operating expenses plus the authorized return on capital. If the projections that underlie this calculation thereafter prove correct—such as estimates of labor and tax expenses, and the level of customer demand—then the carrier's net revenues will match precisely the carrier's authorized return. Obviously, this will virtually never occur, although the gap between the actual return and the projected return may more often than not be relatively small.

The Commission's refund rule was announced in *Authorized Rates of Return for Interstate Services of AT&T Communications and Exchange Telephone Carriers*, 50 Fed.Reg. 41,350 (1985), *reconsideration denied*, FCC No. 86-114 (Mar. 24, 1986), *further reconsideration denied*, FCC No. 86-544 (Jan. 14, 1987). The refund rule extends the use of the rate of return beyond its role in prospectively determining a carrier's rates. Specifically, the Commission would require a carrier to refund all revenues it ultimately collects that exceed the target rate of return by more than a specified amount.

Under the refund rule, the Commission will set a target rate of return, and will require carriers to file rates reflecting the target, for a subsequent two-year period. The Commission will review the filed rates to determine whether they are just and reasonable, and in particular whether the carrier has properly incorporated the target return the Commission has set. *See* 50 Fed. Reg. at 41,351. This process does not significantly differ from what the Commission and the carriers have done in the past. But the refund rule also requires each carrier to compare the revenue it actually received during the two-year period with the revenue that, all else being equal, achievement of the target return plus a "buffer" increment would have produced during that same period.[1] If the carrier received more revenue than the target with the buffer would have produced, it must refund the excess to its customers.[2] *See id.* at 41,354-55 & n. 30.

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[1] The Commission also indicated that each carrier may during the two-year period file tariffs that change the carriers' rates to narrow any anticipated gap between actual and targeted revenues at the end of the period. *See* 50 Fed.Reg. at 41,353 & n. 21. *But see infra* note 6.

[2] The Commission determined that the buffer increment above the target would be 50 basis points (.50%) for AT&T. 50 Fed.Reg. at 41,351. For the local exchange companies, the increment is 25 basis points (.25%) for the target return covering all operations,

In addition, the Commission's rule requires the carrier to apply this refund procedure not only to the revenue from its interstate operations taken as a whole, but also to the revenue from certain segments of the carrier's operations. Each of the segments employs rates that, by Commission rule, incorporates the target return. An excess of revenues in any one of those segments triggers a refund; a revenue shortfall below the target return in one segment may not offset an excess in another segment. *See* 50 Fed.Reg. at 41,352-53.[3]

The Commission, in two opinions on reconsideration of the refund rule, modified the rule in various ways but rejected all challenges to the rule's basic structure and operation. *See Memorandum Opinion and Order*, FCC No. 86-114 (Mar. 24, 1986) (order on reconsideration), *summarized in* 51 Fed.Reg. 11,033 (1986); *Memorandum Opinion and Order*, FCC No. 86-544 (Jan. 14, 1987) (order on further reconsideration). These petitions for review followed.

II.

Petitioners assert that the rule as a whole violates the Communications Act, the Constitution, and the Administrative Procedure Act's prohibition of arbitrary and

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and 40 basis points (.40%) for a segment of operations' target return. *Id.* at 41,353. While the Commission indicated that it would review these increments periodically, their review would not coincide with the biennial revision of the rate of return. *Id.* at 41,351.

[3] For this purpose, AT & T's interstate business is divided into two segments, switched services and private line services. The Commission derives the allocation of rates and earnings for the divisions from the Commission's Interim Cost Allocation Manual, which the Commission also employs to allocate AT & T's costs and target its rate levels prospectively. *See* 50 Fed.Reg. at 41,350-52. Pertinent business of the local exchange carriers is divided into three categories—common line, special access, and switched traffic sensitive. *See Reconsideration Order*, slip op. at 19, FCC No. 86-114 (Mar. 24, 1986).

capricious agency action. *See* 47 U.S.C. § 402(g) (Supp. III 1985). They also challenge particular features and applications of the rule. We find one of these challenges dispositive. We agree that the Commission's refund rule is arbitrary and capricious agency action under the Administrative Procedure Act. See 5 U.S.C. § 706(2)(A) (1982).

A.

Under the Communications Act, the Commission has the authority to prescribe rates for a carrier's interstate telecommunications services. *See* 47 U.S.C. § 205(a) (1982). This court has held that the Commission also has the power to prescribe the rate of return to be incorporated into the carrier's rates. *Nader v. FCC*, 520 F.2d at 203-04. The rate of return the Commission prescribes must be sufficient to cover the cost of capital the carrier must raise to do business. *See United States v. FCC*, 707 F.2d 610, 612 (D.C.Cir.1983). The rate of return accordingly embodies the Commission's best estimate, in light of the evidence available to it, of the earnings needed to retain the carrier's capital investors and to attract additional required investment. *See id.*

Counsel for the Commission stated at oral argument that the rate of return the Commission prescribes "is the minimum that it can prescribe." Transcript of Oral Argument ("Tr.") at 29. This is consistent with the Commission's past pronouncements and the way this court has understood those pronouncements. *See United States v. FCC*, 707 F.2d 610, 612 & n. 4 (D.C.Cir.1983); *Nader*, 520 F.2d at 202, 204; *AT & T*, 86 F.C.C.2d at 223; *AT & T*, 57 F.C.C.2d 960, 960-61 (1976); *AT & T*, 38 F.C.C.2d 213, 226, 240-41, 245 (1972); *AT & T*, 9 F.C.C.2d 30, 52 (1967). Since the determination of a carrier's allowed rate of return requires a balance of investor and consumer interests, *see AT & T*, 86 F.C.C. 2d at 223; *AT & T*, 9 F.C.C.2d at 52; *see generally FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603, 64 S.Ct.

281, 288, 88 L.Ed. 333 (1944), the rate of return, as a balance point, represents "at the same time a minimum and a maximum" allowable return. Tr. at 29. If the rate were higher, the balance would tip in favor of the investor; if lower, it would tip in favor of the consumer. According to the Commission, therefore, its selected rate of return is the proper balance between these interests and hence the minimum return the carrier requires. *See United States v. FCC*, 707 F.2d at 612 & n. 4; *Nader*, 520 F.2d at 204; *AT & T*, 9 F.C.C.2d at 52.

It is true of course that a reviewing court may not overturn the Commission's selected rate of return so long as it lies within a "zone of reasonableness." *Jersey Central Power & Light Co. v. FERC*, 810 F.2d 1168, 1177 (D.C.Cir.1987) (en banc), *quoting Washington Gas Light Co. v. Baker*, 188 F.2d 11, 15 (D.C.Cir.1950). But it is the Commission's understanding of its own task, and not our understanding of the court's task, that is before us in this case. The Commission has indicated, at oral argument in this case and in the past, that it prescribes a carrier's rate of return at what it considers to be the necessary minimum.

B.

We think the Commission's refund rule cannot stand because it is inconsistent with the rate of return prescription it purports to enforce. *See, e.g., City of Lawrence v. CAB*, 343 F.2d 583, 588 (1st Cir. 1965).

The refund rule requires the carrier to refund any earnings above the upper bound of target plus buffer, while the carrier may not recoup any shortfall in its earnings below the target. A carrier cannot be expected to receive earnings each year at precisely the prescribed rate of return, and from one two-year period to the next it must forfeit any excess in earnings while absorbing any deficiency. Thus, over the long run the carrier is virtually guaranteed to fall short of earning its re-

quired target rate of return on its combined operations for all such periods viewed together. The Commission itself acknowledged that the refund rule introduces a "systematic bias" that operates to depress carrier earnings below their target "over the long run." 50 Fed. Reg. at 41,351.[4] Indeed, since the Commission views the rate of return as a minimum, the refund rule under the Commission's view would operate over the long run to put a carrier out of business. It should be stressed that this result does not reflect merely the business risk that a carrier is bound to accept under the accepted view that regulation does not guarantee the regulated company a profit. Rather, it is the Commission's refund rule that seems to guarantee the regulated company an economic loss.

The peaks-and-valleys problem also exists, of course, not merely in the long run but for each two-year period for which the Commission sets a target rate of return. A carrier with profitable and unprofitable business segments may easily find that making refunds on the profitable segments means that it earns less than the required minimum rate of return on its overall operations. The carriers' submissions to this court demonstrate that such an outcome is not at all unlikely. *See* Brief of Petitioner AT & T at 28 & n. 33; Reply Brief for the Named Petitioners and Intervenors at 11; Tr. at 22. Indeed, the Commission itself acknowledged that requiring refunds by business segment "may prevent a carrier from earn-

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[4] This comment occurs in the Commission's discussion of the "buffer" increment. The Commission seems to have thought that the buffer disposed of this problem, but it does not. The carriers' submissions indicate that in recent years they have consistently deviated from the authorized return by far more than the buffer amount. *See, e.g.*, Joint Appendix at 136-37. But the carriers do admit, as they must, that if the buffer were large enough for a "careful carrier . . . invariably [to] meet the target, this would be a different case." Tr. at 19.

ing its overall authorized return" within a single two-year period. 50 Fed.Reg. at 41,353.[5]

Finally, we have seen that the Commission defines the target return it prescribes as a return that, if exceeded, would tilt the investor-consumer balance in the investors' favor and result in unjust and unreasonable prices for consumers. *See, e.g., AT & T*, 86 F.C.C.2d at 223. And it is undisputed that carriers must set their rates by reference to the prescribed return. But in its promulgation of the refund rule, the Commission rejected a suggestion that it eliminate any buffer and simply require the refund of all carrier earnings that exceed the target by saying that earnings within the buffer but above the target need not be refunded because "a target return is in reality a point within a zone of reasonableness. Returns that slightly exceed such a target have never been and should not be deemed unjust." 50 Fed.Reg. at 41,355. This statement contradicts the Commission's later explicit statement at oral argument before this court, and the Commission's prior statements, that the prescribed rate of return represents at once both the carrier's minimum and maximum necessary return. For this reason alone, we are constrained to invalidate the refund rule.

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[5] The Commission also stated that the impact of the refund rule on the carriers would be blunted by each carrier's ability to adjust its rates during the two-year period if it believes that its earnings will miss the target. *See* 50 Fed.Reg. at 41,353. But the Commission has refused to say whether it will accept corrective rate filings that incorporate a return *higher* than the target, *see* Brief of Respondent at 33 n. 45, which is the filing that a carrier whose earnings fell short of the target during the first year of the period would have to make. Even apart from the practical barriers to making corrective adjustments, *see* Tr. at 18-19, we will not rely on the ability to adjust when the Commission itself refuses to say whether it would permit all the adjustments that carriers would need to make.

It may be that the Commission considers the rate of return for rate-setting purposes as something different from the rate of return for refund purposes (a question on which we take no position). It has not attempted to provide any such understanding to this court. On remand, if the Commission wishes to promulgate a new refund rule, it must clearly and specifically explain what it understands the rate of return to be and how that understanding is consistent with a refund rule.

We are convinced, therefore, that the Commission's own understanding of its rate of return prescription and of its refund rule constitutes a self-contradiction. Since we find that the refund rule as a whole is unreasonable agency action, it is not necessary for us to consider petitioners' other arguments.

III.

For the guidance of the parties in case the Commission chooses to reformulate the refund rule, we offer comments on two of the issues raised by petitioners.

First, regarding petitioners' constitutional argument that the refund mechanism is an unconstitutional taking of their property, the Commission should explain how an operation of the mechanism on business segments that would result in pushing the carriers' total return below a reasonable level would be consistent with the constitutional doctrine that an agency rate order "viewed in its entirety" must produce a just and reasonable "total effect" on the regulated business. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602, 64 S.Ct. 281, 287, 88 L.Ed. 333 (1944). Investors in a carrier, after all, must invest in the carrier as a whole, and not just in one or another of its business segments.

Second, we observe that a panel of this court has decided in *New England Telephone & Telegraph Co. v. FCC*, 826 F.2d 1101 (D.C.Cir.1987), that the Commission has statutory authority to employ a refund mecha-

nism in conjunction with rate of return regulation.[6] In *New England Telephone*, the Commission had attempted in an individual case to exercise the very authority to impose refunds that it now seeks to assert generically. The Commission had ordered a rate refund of one hundred million dollars to reimburse consumers for 1978 earnings by the AT & T system in excess of the then-outstanding rate-of-return prescription. We determined that the Commission's order was a valid exercise of its ratemaking authority under the Communications Act. Specifically, we reiterated our holding in *Nader v. FCC*, 520 F.2d 182 (D.C.Cir.1975), that the Commission has power under section 205 of the Act to prescribe rates of return as well as rates. We then determined that the Commission's refund order was a reasonably necessary enforcement mechanism for its rate-of-return prescription and therefore was authorized under section 4(i) of the Act, which permits the Commission to "perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this [Act], as may be necessary in the execution of its functions." 47 U.S.C. § 154(i) (1982).

New England Telephone clearly defeats the claim that a refund scheme in conjunction with rate-of-return regulation is necessarily incompatible with the regulatory scheme embodied in the Communications Act. A prescription of a rate of return was described in *New England Telephone* as representing a proclamation by the Commission that earnings in excess of the prescribed rate are unlawful and shall not occur. *See New England Telephone*, 826 F.2d at 1106. The Commission refund scheme was viewed therefore as simply forcing carriers to disgorge earnings they never had a right to collect. Although the enforcement mechanism that the Commis-

[6] The opinion in *New England Telephone* issued after oral argument in this case, and a suggestion for rehearing *New England Telephone en banc* is currently pending before this court.

sion chose may not have been the only conceivable one, it was found to be within the range of reasonable remedies that the Commission may employ in its discretion under section 4(i). *Id.* at 1107-08. It should be noted, however, that the particular refund scheme at issue in *New England Telephone* was found by this court to provide "ample protection for the carriers' interests," and we went on to say, "[s]hould this state of affairs not hold in the future, the Commission and the courts can address the situation at that time." *Id.* at 1109.

Thus, as we previously have concluded, the Commission has authority under the Act to order refunds where a carrier has violated an outstanding rate-of-return prescription. That authority must, however, be exercised in a way that does not contradict the Commission's own theory of rate of return regulation. *See supra* pp. 1389-1392. An obvious example of a scheme that would be consistent with the Commission's view of the rate of return prescription as a minimum, is one in which the carrier, in addition to being required to return amounts that exceeded the target return, would be permitted to recover amounts by which it fell short of the target. We are confident that the Commission can imagine other schemes that would not tend to prevent carriers from earning the return needed to enable them to attract necessary capital. It is of course the Commission, not this court, that is empowered to exercise its judgment in choosing a course of action. We do not mean to suggest that any one valid course of action is preferable to any other. If the Commission's choice is to survive judicial scrutiny, however, it must conform to the Commission's understanding of its task. If the Commission wishes to reformulate that understanding, then to the extent that it is "changing its course[, it] must apply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored. . . ." *Greater Boston Television Corp. v. FCC*, 444 F.2d 841,

852 (D.C.Cir.1970), *cert. denied*, 403 U.S. 923, 91 S.Ct. 2229, 29 L.Ed.2d 701 (1971).

We grant the petitions for review and remand the case to the Commission so that it may fashion, if it wishes, a refund mechanism that does not contradict the Commission's understanding of its rate of return prescription.

It is so ordered.

STARR, Circuit Judge, concurring:

I concur in the court's judgment and in much of its opinion. In my view, Congress well knew what it was doing in comprehensively and carefully crafting the Communications Act. That regime, I believe, does not allow the remedy that the agency has suddenly discovered a half-century after the Act's passage. Although a panel of this court has recently (during the period when the present case was *sub judice*) held to the contrary, that case is still pending before the court. Under these circumstances, it seems to me appropriate to set forth the reasons for my conclusion that the FCC's innovations of late are without statutory foundation.

I

The terms and structure of the Communications Act bear decisively upon the FCC's latter-day inspiration as to reach of its regulatory powers. Briefly stated, sections 201 to 205 of the Act deal with rates. Under section 203, the all-important requirement of filing a schedule of charges is laid out: "Every common carrier, except connecting carriers, *shall* . . . file with the Commission . . . schedules showing all charges." (emphasis added) This is an absolute condition precedent to doing business. Unless schedules have been filed, section 203(c) tells us, "no carrier . . . shall engage or participate in such communication. . . ." In addition, section 203(c) mandates that carriers scrupulously abide by the schedules as filed.

With this foundation, the statute goes on to provide the Commission with two instruments of control over the content of the schedules. Section 204(a) permits the Commission to suspend the operation of a newly filed charge while it investigates the rate's lawfulness and, after a full hearing, to make whatever order as "would be proper." Under section 205(a), the Commission is "authorized and empowered to determine and prescribe what will be the just and reasonable charge . . . to be thereafter observed" if the "Commission shall be of [the] opinion that any charge . . . is or will be in violation of any of the provisions of [the Act]. . . ." This combination of powers represents an architecturally harmonious regulatory scheme: the Commission enjoys corrective power at both stages of the process. Under section 204, it may reject rates before a proposed schedule goes into effect; under section 205, it may prescribe new rates to override a schedule currently in effect.

Once the Commission has allowed the schedule to become effective, the statute sets forth specific methods of enforcement. If the carrier fails to abide by a filed tariff (in violation of section 203(c)), then the faithless carrier is subject to penalties (in the form of fines) under section 203(e). If a carrier knowingly fails or neglects to follow a prescription (in violation of section 205(a)), it is subject to penalties (also in the form of fines) under section 205(b). Each statutory section containing a specific mandate thus contains a corresponding penalty for violation (*see also* section 202(a), prohibiting discrimination in charges, and section 202(c), subjecting the carrier to penalties for violation of 202(a)). If, say, a section 205(a) prescription is violated, the Commission may invoke the remedial mechanism crafted specifically to deal with such violations (found in section 205(b)).

In crafting this elaborate scheme, Congress did not leave an injured customer without a remedy; to the contrary, the statute expressly provides for consumer

remedies. In section 206, the carrier is put on notice that if it violates the Act, it will be liable to persons injured by its actions. Sections 207-209 then set forth in detail the procedures through which an aggrieved customer can obtain relief. The statute is clear, however, that the customer must initiate these proceedings, save for one limited situation. Under section 204(a), if the Commission has suspended rates, but has been unable to complete its investigation and hearing within five months, the new or revised charge goes into effect. In that event, the Commission is authorized to require the carrier to account for all amounts received, and upon completion of the hearing, the agency may require the carrier to refund, with interest, the portion of amounts paid that was not justified.

An examination of the statute as a whole makes crystal clear that the schedule filed by a carrier serves as the foundation by which Congress' regulatory scheme achieves stability, predictability, and protection of the public interest. Once the schedule is filed and allowed to go into effect, carriers (and consumers) are entitled to rely on it, except for the one special situation addressed (and procedurally safeguarded) in section 204. This is not anything novel. In the analogous rate regulatory scheme administered by the ICC, the Supreme Court has repeatedly "stressed the importance of common carriers' being able to rely on effective tariffs on file with the Commission." *ICC v. American Trucking Associations, Inc.*, 467 U.S. 354, 364 n.7, 104 S.Ct. 2458, 2464 n. 7, 81 L.Ed.2d 282 (1984) (referring to *Berwind-White Coal Mining Co. v. Chicago and Erie Railroad Co.*, 235 U.S. 371, 35 S.Ct. 131, 59 L.Ed. 275 (1914) and *Davis v. Portland Seed Co.*, 264 U.S. 403, 44 S.Ct. 380, 68 L.Ed. 762 (1924)). And there should be no doubt about the relevance of the Supreme Court's teaching under the "prototypical ratemaking statute, the Interstate Commerce Act"; it is well settled that "the principles of

judicial review of agency refund decisions in ratemaking cases are of general applicability." *Las Cruces TV Cable v. FCC*, 645 F.2d 1041, 1047 (D.C.Cir.1981). To observe but one example of this pervasiveness, recognition of the role of fidelity to filed schedules in ensuring stability and fairness undergirds the "filed rate doctrine" articulated in the area of energy regulation. *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 576-79, 101 S.Ct. 2925, 2929-31, 69 L.Ed.2d 856 (1981). Under this doctrine, which "has its origins in . . . cases interpreting the Interstate Commerce Act" and "has been extended across the spectrum of regulated utilities," *id.* at 577, 101 S.Ct. at 2930, the Commission "may not *impose* a retroactive rate regulation and, in particular, may not order reparations," *id.* at 578 n. 8, 101 S.Ct. at 2930 n. 8 (emphasis in original).

II

In view of this carefully crafted scheme, it is apparent that the refund rule that the Commission advances here does clear violence to the values of stability and predictability that Congress so carefully enshrined in the Communications Act. In the Commission's Orwellian world, carriers are no longer able to rely on filed rates; instead, they go about their business in constant jeopardy of being forced to refund enormous sums of money, even though they complied scrupulously with their filed rates. The Commission, inspired by its own victory in *Nader*, has turned the regulatory world upside down.

The Act, which is purely prospective in design, manifestly does not contemplate this unsettling state of affairs. As I have detailed above, Congress constructed the Act so that the Commission's remedial power is limited to prospective relief: when the Commission determines that existing rates are excessive, it cannot order a refund of past payments under the revoked rate. Rather, the FCC can only correct the problem through a *prospective* prescription under section 205. The courts have consistently

adhered to this basic rule of ratemaking. *See, e.g., Arizona Grocery Co. v. Atchison, Topeka and Santa Fe Railway Co.*, 284 U.S. 370, 390, 52 S.Ct. 183, 186, 76 L.Ed. 348 (1932) ("Where the Commission has . . . declared what is the maximum reasonable rate to be charged by a carrier, it may not at a later time . . . subject a carrier which conformed thereto the payment of reparation measured by what the Commission now holds it should have decided in the earlier proceeding to be a reasonable rate."); *Sea Robin Pipeline Co. v. FERC*, 795 F.2d 182, 189 n. 7 (D.C.Cir.1986) (the Commission "may not order a retroactive refund based on a post hoc determination of the illegality of a filed rate's prescription.").

The question is therefore whether *Nader* somehow indirectly demolished this longstanding example of harmonious statutory architecture. The answer, demanded by law and basic notions of democratic theory, is obviously no. Although *Nader* added a new wrinkle to the rate regulatory system by allowing the Commission to prescribe the rate of return (*a mere component of a rate*), I am at a loss to understand why *Nader* brings with it an *enforcement mechanism* that contravenes the terms, structure, and goals of the Act itself. To be sure, the Commission's *Nader*-blessed rate-of-return prescription would have more teeth with the "refund rule" in effect. But, that approach carries us too far. In the post-*Nader* world heralded by the Commission, the FCC's determination of what constitutes a just and reasonable rate would carry more force if the Commission could order a refund of (previously approved) rates collected in excess of the just and reasonable amount. That, however, is exactly what the statute (and the *Arizona Grocery/Sea Robin* line of cases) incontrovertibly prohibits.

That is not to say that the Commission is without recourse in that situation. Quite to the contrary, the

FCC is at liberty to use its Congressionally conferred section 205 power to prescribe just and reasonable charges *for the future*. The result should be the same when the Commission is exercising the *ancillary* power approved in *Nader*: once it determines that a tariff is properly targeted to the prescribed rate of return and allows it to become effective, the Commission should repair to prospective revisions.

Indeed, since the Commission's duty is to ensure that *rates* are just and reasonable (not to ensure that a certain rate of return is met), *see* 47 U.S.C. § 201(b), it is passing strange to allow the Commission to order refunds (and thereby undercut the Congressionally ordained values of stability and predictability) where a rate-of-return prescription is exceeded, but not where a just and reasonable charge is exceeded. Likewise, because the statute contains specific penalty provisions, it is unlikely that the Commission would have authority to require a refund when a filed tariff or a *rate* prescription is violated.

III

In sum, the terms and structure of this 53-year old statute prohibit the Commission's exercise of this newly discovered clawback authority. This conclusion is buttressed by the fact that one year before the passage of the Communications Act, Congress repealed section 15(a) of the Interstate Commerce Act, which contained a "recapture" provision strikingly similar to the agency-created one at issue in this case. From 1920 to 1933, the Interstate Commerce Act contained a provision that mandated the Commission to establish rates so that the "carriers as a whole" would earn a fair return. The provision also provided that, since "it is impossible . . . to establish uniform rates . . . which will adequately sustain all the carriers . . . without enabling some of such carriers to receive a net railway operating income substantially and unreasonably in excess of a fair return,"

carriers who received an excessive return (which was deemed income in excess of 6% of the value of the railway property) would have to place half of the excess in a carrier-maintained reserve and half in a "general railroad contingent fund." Transportation Act of 1920, 41 Stat. 456, 488-91.

In 1933, Congress repealed the provision. It replaced the ill-fated scheme with a "rule of ratemaking," that is to say certain factors the Commission was to consider when setting rates. The Conference Report explains that the "experience of the last twelve years" showed (1) the impossibility of maintaining the level of rates required to produce the percentage rate fixed by the statute, and (2) the destabilizing (and debilitating) effects of changing the rate level to meet the inevitable fluctuations in revenue. H.R.Conf.Rep. No. 213, 73rd Cong., 1st Sess. 29 (1933). The chairman of the ICC's legislative committee is quoted in the Report as stating: "[T]here is something incongruous in a system of regulation which finds it necessary to permit carriers to earn more than they ought to earn, and meets the difficulty by taking money away after it is received." *Id.* at 30.

It is evident that Congress agreed with the sober assessment of the chairman. And in the wake of that bitter lesson learned the hard way, it strains credulity to maintain, as the FCC does, that Congress meant in 1934 to weave silently into the Communications Act the same tort of refund authority that it found unworkable in the statutory paradigm, the Interstate Commerce Act.

Finally, it should not be assumed that my analysis defangs *Nader*, leaving it a toothless victory for the Commission. In *Nader* itself, it bears remembering, the "refund rule" was not even at issue. The Commission was fighting, instead, for other benefits that would flow from regulatory prescribing of rates of return. And those benefits were beguiling indeed—they included limiting

carriers' discretion to initiate rate revisions, *see Nader*, 520 F.2d at 201, and giving the agency the ability summarily to reject any tariff revision designed to achieve more than the prescribed rate of return, *see id.* at 202. Now the Commission wants more. We should say no. This goes too far. We should limit the Commission to its not insubstantial fruits harvested in *Nader*, and avoid wreaking havoc in the communications industry and the previously architecturally sound and sensible law of rate-making. In this age of deference to the largely unaccountable organs of government, we must not permit those quasiautonomous creatures of the political branches to tear asunder that which the representatives of the people have seen fit to ordain and maintain for a quarter of the Nation's history. To do so is a misguided affront to basic principles of republicanism.

APPENDIX H

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 85-1778

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,
Petitioners

v.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA,
Respondents

and consolidated cases

Before: Wald, Chief Judge; Robinson, Mikva, Edwards, Ruth B. Ginsburg*, Starr, Silberman*, Buckley, Williams, D.H. Ginsburg, and Sentelle*, Circuit Judges

ORDER

[Filed Nov. 2, 1988]

Respondent's Conditional Suggestion for Rehearing *En Banc* and the responses and replies thereto have been circulated to the full court. The taking of a vote thereon was requested. Thereafter, a majority of the judges of the Court in regular active service did not vote in favor

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* Circuit Judges Ruth B. Ginsburg, Silberman and Sentelle did not participate in this order.

of the suggestion. Upon consideration of the foregoing it is

ORDERED, by the Court *en banc*, that the suggestion is denied.

FOR THE COURT:

CONSTANCE L. DUPRE
Clerk

By: /s/ Robert A. Bonner
ROBERT A. BONNER
Deputy Clerk

A dissenting statement of Circuit Judge Starr, in which Circuit Judges Williams and Buckley join, is attached.

A separate statement of Circuit Judge D.H. Ginsburg is also attached.

STARR, *Circuit Judge*, joined by WILLIAMS and BUCKLEY, *Circuit Judges, dissenting from denial of rehearing en banc*: The fundamental issue presented in these cases is of manifest importance. Not only are the economic stakes staggeringly high, but the FCC has expansively asserted a recently discovered power enshrouded for a half century in the mists of the Communications Act of 1934. This recent discovery at 19th and M Streets represents yet another example in the long and dreary line of bureaucratic excesses in our system of limited government. The FCC has, in brief, purported to exercise a power which Congress never conferred upon it; what is worse, the Commission's clawback approach and mandating of the maximum rate of return do violence to well-settled, salutary doctrines, such as the bar on retroactive ratemaking and the filed rate doctrine. In the process, the Commission's ratemaking revolution flies in the teeth of the twin virtues of stability and predictability which rate regulatory regimes are designed to foster.

The errors complained of are, in short, profound. Unfortunately, as the order denying the suggestion indicates, a number of our judges have not been able to participate in evaluating the merits of what I believe to be a compelling demonstration by Comsat and other telecommunications firms that the *New England* majority was badly wrong This substantial shortage in judicial personnel has virtually foreordained that this issue cannot now be offered the *en banc* treatment that it so plainly deserves. Under these circumstances, the state of the law in this circuit on a pivotal statutory issue cutting across agency lines can only be regarded as distressingly unsettled until the question arises in a context where the court can truly turn its full evaluative powers to the question at hand.

Separate Statement of Circuit Judge D. H. Ginsburg: As I was not a member of the panel in either of these cases and, therefore, did not receive the benefit of plenary briefs and oral argument, I am not in a position to speak with the conviction expressed by Judge Starr. I do not doubt, however, that the issues raised by his thoughtful statement warrant examination by the court *en banc*.

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 85-1778

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,
Petitioner

v.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA,
Respondents

and consolidated cases

Before: Mikva and Starr, Circuit Judges

ORDER

[Filed Nov. 2, 1988]

Upon consideration of respondent's petition for conditional suggestion for rehearing, it is

ORDERED, by the Court, that the petition is denied.

FOR THE COURT

CONSTANCE L. DUPRE
Clerk

By: /s/ Robert A. Bonner
ROBERT A. BONNER
Deputy Clerk

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 85-1778

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,
Petitioner

v.

FEDERAL COMMUNICATIONS COMMISSION and the
UNITED STATES OF AMERICA,
Respondents

and consolidated cases

Before: Wald, Chief Judge; Robinson, Mikva, Edwards, Ruth B. Ginsburg*, Starr, Silberman*, Buckley, Williams, D.H. Ginsburg* and Sentelle*, Circuit Judges

ORDER

[Filed Nov. 23, 1988]

It is ORDERED, by the Court *en banc*, on its own motion, that the order filed on November 2, 1988, denying petitioners' suggestion for rehearing *en banc* is amended as follows:

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* Circuit Judges Ruth B. Ginsburg, Silberman, D.H. Ginsburg and Sentelle not participate in this order.

(1) The names of the judges are amended by adding an asterisk next to the name of Circuit Judge D.H. Ginsburg as follows:

Before: Wald, Chief Judge; Robinson, Mikva, Edwards, Ruth B. Ginsburg*, Starr, Silberman*, Buckley, Williams, D.H. Ginsburg* and Sentelle*, Circuit Judges

(2) Insert the name of Circuit Judge D.H. Ginsburg in the fourth sentence from the end of the order, to read as follows:

"*Circuit Judges Ruth B. Ginsburg, Silberman, D.H. Ginsburg and Sentelle did not participate in this order."

(3) Delete the following sentence, in its entirety, from the order:

"A separate statement of Circuit Judge D.H. Ginsburg is also attached."

(4) Delete, in its entirety, the "Separate Statement of Circuit Judge D.H. Ginsburg."

It is FURTHER ORDERED, by the Court *en banc*, that all other aspects of the Court's November 2, 1988, order remain the same.

For the Court:

/s/ Constance L. Dupre
CONSTANCE L. DUPRE
Clerk

APPENDIX I

STATEMENT PURSUANT TO SUP. CT. RULE 28.1

Based on information furnished by counsel for the companies in question, the following are non-wholly owned parents, subsidiaries or affiliates of petitioners.

New England Telephone & Telegraph Company, and New York Telephone Company are wholly owned subsidiaries of NYNEX Corporation. NYNEX Credit Company, a subsidiary of NYNEX Corporation, has outstanding securities in the hands of the public.

Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Company, and Pacific Northwest Bell Telephone Company are wholly owned subsidiaries of U S WEST Inc., which has one non-wholly owned subsidiary, U S WEST New Vector Group, Inc.

Illinois Bell Telephone Company, Indiana Bell Telephone Company, Inc., Michigan Bell Telephone Company, The Ohio Bell Telephone Company, and Wisconsin Bell, Inc. are wholly owned subsidiaries of American Information Technologies Corporation ("Ameritech"). Neither Ameritech nor any of the Ameritech Operating Companies owns a subsidiary with publicly traded common or preferred stock issues.

GTE Service Corporation, and the GTE Domestic Telephone Operating Companies are subsidiaries of GTE Corporation. The following are subsidiaries or affiliates of GTE Corporation that have outstanding securities in the hands of the public:

GTE California Incorporated
GTE Florida Incorporated
GTE Hawaiian Telephone Company Incorporated
GTE North Incorporated
GTE Northwest Incorporated
GTE South Incorporated

GTE Southwest Incorporated
La Compagnie de Telephone Anglo-Canadienne/
Anglo-Canadian Telephone Company
British Columbia Telephone Company
Pachena Industries Ltd.
SMT Northwest Inc.
Quebec-Telephone
GTE Airfone Incorporated
Skytel Communications Corporation
Claude S.A.
GTE Electronica, S.A.
GTE Sylvania, S.A. de C.V.
GTE Sylvania, S.A. Electronics,
Quimica Industrial y Commercial
Kondo Sylvania Limited
Focos, S.A.
Commonwealth Manufacturing Corporation
GTE Directories Corporation Limited
GTE Directories Corporation-Meller S.A. (UTE)

United States Telephone Association has no non-wholly owned parents, affiliates or subsidiaries.

No. 88-1249 and 88-1250

FILED
APR 3 1989
JOSEPH F. SPANIOL, JR.
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1988

SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY, ET AL., PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, ET AL., PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

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35pp

QUESTION PRESENTED

Whether the Commission has authority under the Communications Act of 1934, 47 U.S.C. 151 *et seq.*, to enforce its 1976 prescription of a rate of return for 1978 rates by requiring carriers to refund, through prospective rate reductions, revenues collected in 1978 in excess of the maximum prescribed return.

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In the Supreme Court of the United States

OCTOBER TERM, 1988

No. 88-1249

SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY, ET AL., PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

No. 88-1250

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, ET AL., PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-39a)[1] is reported at 826 F.2d 1101. The initial order of the Federal Communications Commission (Pet. App. 40a-72a) is reported at 102 F.C.C.2d 52. The Commission orders denying reconsideration (Pet. App. 86a-120a, 121a-129a) are not reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 130a-132a) was entered on August 21, 1987. A petition for

[1] "Pet. App." refers to the appendix to the petition for a writ of certiorari in No. 88-1250.

rehearing was denied on November 2, 1988. Pet. App. 133a-140a. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Under the Communications Act of 1934, 47 U.S.C. 151 *et seq.* (Act), the Federal Communications Commission (FCC or Commission) is responsible for ensuring that the regulations, classifications, charges, and practices of carriers of interstate and foreign communications are just, reasonable, and non-discriminatory. 47 U.S.C. 201(b), 202(a). The Act provides the Commission with a number of regulatory tools to carry out that broadly defined responsibility. In particular, under Section 205, the Commission may investigate a carrier's rates and practices; and if, after a hearing, it finds that a rate or practice is or will be unlawful under the Act, the Commission may prescribe just and reasonable rates or practices "to be thereafter observed." 47 U.S.C. 205(a). Such a prescription is binding on the carrier, which "shall not thereafter publish, demand, or collect any charge other than the charge so prescribed, or in excess of the maximum * * * so prescribed * * * and shall conform to and observe the regulation or practice so prescribed." *Ibid.* Any such prescription is binding for the time specified in the Commission's order or until the order is superseded. 47 U.S.C. 408. See *Permian Basin Area Rate Cases,* 390 U.S. 747, 779 (1968) (no "limitations of time" imposed by statute on agency prescription order); *AT & T* v. *FCC,* 487 F.2d 865, 880 (2d Cir. 1973).

The Commission has additional powers to investigate the lawfulness of proposed new practices or charges under Section 204 of the Act. It may suspend the effectiveness of such practices or rates for up to five months pending its investigation. In the case (as is involved here) of a proposed

increased rate, if the investigation is not completed after the specified period of suspension, the Commission may allow the rate to take effect but require the carrier to keep an accounting of the amounts it collects under the rate. At the end of the investigation, the Commission may order the carrier "to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such charge * * * as * * * shall be found not justified." 47 U.S.C. 204(a).

Supplementing those and other express provisions of the Act, Section 4(i) authorizes the agency to "perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions." 47 U.S.C. 154(i). That provision is a "necessary and proper clause." *North American Telecomm. Ass'n* v. *FCC*, 772 F.2d 1282, 1292 (7th Cir. 1985). It gives the FCC a flexible and wide-ranging power to take steps to implement Congress' broadly worded directives defining the Commission's rate regulation and other responsibilities.[2]

In 1972, the Commission, under its Section 4(i) authority to take necessary and proper measures to implement its Section 205 power to prescribe just and reasonable rates and practices, asserted the authority to prescribe the rate of return a carrier may earn. See Pet.

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[2] See, *e.g.*, *City of New York* v. *FCC*, 108 S. Ct. 1637, 1643 (1988); *Capital Cities Cable, Inc.* v. *Crisp*, 467 U.S. 691, 700 (1984); *North American Telecomm. Ass'n* v. *FCC*, 772 F.2d at 1292-1293. Cf. *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 642 (1972) (Natural Gas Act, 15 U.S.C. 717*o*) ("the Commission must possess broad powers to devise effective means to meet these responsibilities"); *Permian Basin Area Rate Cases*, 390 U.S. 747, 774-777 & n.40 (1968) (same).

App. 4a-5a.[3] That authority was upheld by the D.C. Circuit and has not been questioned elsewhere. *Nader* v. *FCC,* 520 F.2d 182, 203-204 (D.C. Cir. 1975). See *United States* v. *FCC,* 707 F.2d 610 (D.C. Cir. 1983). The D.C. Circuit ruled that such rate of return prescriptions are "necessary for the Commission to carry out its [ratemaking] functions in an expeditious manner." *Nader* v. *FCC,* 520 F.2d at 204. Cf. *FPC* v. *Tennessee Gas Transmission Co.,* 371 U.S. 145, 150-155 (1962) (upholding FPC's order of refund based on determination of the reasonable rate of return, prior to any determination of how the costs of service should be allocated). The court also explained that a rate of return prescription, like any other Section 205 prescription, is binding: it limits the utility prospectively to the prescribed return. *Nader* v. *FCC,* 520 F.2d at 201. The court further pointed out that, although such a prescription protects the carrier from "the possibility of refunds on the ground that [the] * * * [prescribed] return [i]s too high, the Commission retains full latitude to order refunds on all other grounds." *Id.* at 205 n.25.

2. a. This case involves the FCC's enforcement of a rate of return prescription. In 1976, after a lengthy hearing, the Commission prescribed a rate of return of 9.5 percent for AT & T and its then-affiliated operating companies. *AT & T,* 57 F.C.C.2d 960 (Feb. 5, 1976). Although 9.5

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[3] The rate of return is one of the components of the formula that is typically used to determine the revenue requirements, and hence the rates, of a regulated company. The rate of return may be defined as "the amount of money a utility earns, over and above operating expenses, depreciation expense, and taxes, expressed as a percentage of the legally established net valuation of utility property, the rate base." P. Garfield & W. Lovejoy, *Public Utility Economics* 116 (1964). Under one common form of rate regulation, a regulated carrier is authorized to set rates that will recover its legitimate expenses (including depreciation and taxes) plus a reasonable return (the rate of return) on its rate base (the net investment of property).

percent was the prescribed return, the Commission afforded the company a .5 percent margin of error, specifying that "AT&T should be permitted 'a level or range of interstate earnings not to exceed 10%' " and that the Commission would not require "any downward adjustment of AT&T's overall interstate rates provided its overall rate of return does not exceed 10 percent." *Id.* at 973.

AT & T filed rates that it stated were designed to achieve the prescribed rate of return of 9.5 percent. Without finding that the rates were just and reasonable, the Commission, exercising its Section 204 power, suspended the rates for one day and then permitted them to go into effect on February 29, 1976, subject to an accounting order for possible refund. *AT & T*, 58 F.C.C.2d 1, 4 (Feb. 26, 1976).[4] AT & T was required to keep an accounting, not customer-by-customer, but "by service classes and subclasses, in the aggregate." *Id.* at 5.

In requiring the accounting and retaining the power to compel a refund, the Commission stated that its recent prescription of the rate of return had left unresolved "numerous other issues * * * which control the individual rates which AT & T may charge for specific services and the expenses and rate base upon which the rate of return is calculated." 58 F.C.C.2d at 4. The Commission expressly listed other components of a full determination of a just and reasonable rate—the correctness and legitimacy of AT & T's claimed investments, cash expenses, and non-cash expenses such as depreciation, and whether "the rates proposed or in effect actually * * * produce a fair rate of return." *Ibid.* (quoting *Nader* v. *FCC,* 520 F.2d at 204). Of course, without resolving those issues, it was not possible to determine whether the actual rates charged by AT & T

[4] The Commission limited the suspension to a single day in order to avoid subverting AT & T's "opportunity to earn the fair rate of return which we have prescribed." 58 F.C.C.2d at 4.

would produce the rate of return that the Commission prescribed.[5]

b. After the rates had become effective and had been collected for almost three years, the data contained in monthly reports that AT & T filed with the Commission indicated that AT & T's earnings in 1978 had exceeded not only the authorized return of 9.5 percent but also the established buffer of an additional .5 percent. Accordingly, in October 1979, the Commission issued a notice of inquiry to determine what action it should take in response to the apparent violation of its rate of return prescription. *Inquiry Concerning AT&T's Earnings on Interstate and Foreign Services During 1978,* 75 F.C.C.2d 412 (1979).[6] In requesting comments on what action it should take, including comments on the option of ordering a refund, the notice of inquiry twice pointed to the suspension and accounting order that allowed the 1978 rates to take effect (*id.* at 414 n.5, 415 n.6) and stated that the notice was

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[5] Petitioners fail to mention that the 1978 rates (filed in 1976) took effect subject to an accounting order. Petitioners in No. 88-1249 state that "there was no relevant accounting order." 88-1249 Pet. 6. Petitioners in No. 88-1250 state that AT & T "filed rates * * * and the FCC allowed them to become effective" (88-1250 Pet. 6); they also state that "[n]o suspension, investigation and accounting order was entered in connection with Bell's rate of return when it filed its rates in 1976" (*id.* at 14 n.19).

[6] The 1976 rate of return prescription of 9.5 percent was in effect for five years. During that time, AT & T's overall rate of return was 9.69 percent. Moreover, in four of the five years—all of the years in which the prescription was in effect for all 12 months—AT & T's rate of return exceeded 9.5 percent. Pet. App. 14a-15a. In 1976, AT & T's earnings were 9.25 percent; but its authorized rate of return during the first two months of that year was only 8.5 percent. *AT & T,* 38 F.C.C.2d 213, 245 (1972). The Commission's order prescribing a 9.5 percent rate of return was released on February 5, 1976, and the new rates implementing that prescription became effective on February 29. *AT & T,* 57 F.C.C.2d at 960; *AT & T,* 58 F.C.C.2d at 1, 4, 5.

issued pursuant to Sections 4(i), 204, and 205 of the Act (among others) (75 F.C.C.2d at 416).

c. After considering the comments filed by industry and consumer groups, the Commission determined that AT & T had earned a rate of return for its interstate and foreign services of 10.22 percent during 1978. Pet. App. 46a-51a. Noting that there were insuperable practical obstacles (especially after the AT & T divestiture) to distributing individually calculated refunds to each of the millions of AT & T's 1978 ratepayers, many of whom might no longer be in existence or identifiable, the Commission chose instead a class-wide refund mechanism consistent with the non-individualized accounting that it had required for the filing of the rates at issue: the Commission required downward adjustments of 1985 rates, to be apportioned among AT & T and the divested Bell Operating Companies (BOCs). *Id.* at 53a-54a. The Commission thus ordered AT & T and the BOCs to pay back the 1978 earnings in excess of a 10 percent rate of return by means of "a temporary discount upon interstate services for a period that is sufficient to reduce carrier revenues by the amount that is to be restored to interstate ratepayers." *Id.* at 52a.

The Commission rejected the suggestion that the 1976 rate of return prescription had not been intended to operate as a limit on AT & T's earnings. The Commission observed that the plain language of the prescription order had provided that AT & T's earnings were " 'not to exceed 10 percent.' " Pet. App. 56a. Relying on Section 205, the Commission noted that a "carrier is under an affirmative duty to revise its rates to conform to [an] outstanding prescription order." Pet. App. 58a. It further observed that "[t]he proper procedure for a carrier who contends that an outstanding order is improper is to petition the Commission to modify that order," which AT & T did not do. *Id.* at 56a-57a (footnote omitted).

The Commission also rejected the argument that it had accepted the rates when they were filed in 1976, that those rates had become lawful, and that the Commission could not later declare them unlawful. Pet. App. 57a-58a. The Commission pointed out that it had never found that the 1978 charges were just and reasonable and, indeed, had found some charges for particular services that were in effect in 1978 to be unlawful in other proceedings. *Id.* at 57a. It elaborated on that conclusion in a lengthy Appendix B to its decision (*id.* at 73a-85a), which noted that the rates in effect in 1978 had been suspended and subjected to an accounting order issued in reliance on Section 204 and Section 4(i) (Pet. App. 73a, 85a).

Finally, the Commission rejected the contention that it lacked authority to order a refund because Section 205 of the Communications Act did not specifically authorize refunds of revenues in excess of a prescribed rate of return. The Commission pointed simply to its Section 4(i) authority. It concluded that the court in *Nader* v. *FCC*, 520 F.2d at 204-205 & n.25, had recognized that "the power to order refunds is inherent in the Commission's prescription authority." Pet. App. 59a.

d. On reconsideration, the Commission reaffirmed its authority to adopt the restitution mechanism. See Pet. App. 101a-105a. The Commission rejected the contention that the order constituted retroactive ratemaking. *Id.* at 101a-104a. It noted that the restitution order "involved the enforcement of an outstanding order that was by its terms prospective" (*i.e.*, the 1976 rate of return prescription); and it pointed out again that it had never "authorized" the 1978 rates (*id.* at 102a n.55 (citing Appendix B of its initial order)). The Commission observed that *Arizona Grocery Co.* v. *Atchison, Topeka & Santa Fe R.R.*, 284 U.S. 370 (1932) (*Arizona Grocery*), and other ratemaking retroactivity decisions relied on by petitioners, involved "circumstances in which the regulatory body actually set the

specific price, or 'charge', that was to be paid by the user of the regulated entity's service"; here, by contrast, the Commission set the rate of return, not the rate, and the carrier itself set the charges subject to the constraints imposed by the rate of return prescription. Pet. App. 103a n.55, 103a-104a.

The Commission also reaffirmed its rejection of the argument that a rate of return prescription was not intended to be binding but merely to set a goal for future ratemaking. Pet. App. 104a-105a. The Commission cited a D.C. Circuit decision that had upheld a refund decision under Section 204 involving rates that, when filed, had not been found just and reasonable (*Las Cruces TV Cable* v. *FCC*, 645 F.2d 1041 (1981)) and again cited Appendix B of its initial decision, which showed that AT & T's 1978 rates were in a similar position. Pet. App. 104a n.60. The Commission also explained that the particular rate of return prescription order involved here clearly had restricted the amount that AT&T could earn on its interstate operations. While AT & T was required in the first instance to file rates "targeted" to earn 9.5 percent, the order set a "clearly stated upper bound" of 10 percent. *Id.* at 104a-105a. See also *id.* at 109a-111a (citing *Nader* v. *FCC* and FCC decisions since 1972, Commission rejects suggestion that treating rate of return prescription as setting upper bound was a new policy). Finally, the Commission reiterated that the restitution mechanism it chose was amply justified—in preference to a refund of excess charges to each individual 1978 customer—as "the least expensive, and most efficient, approach to effecting restitution." *Id.* at 111a-112a.[7] The Commission subsequently denied petitions seeking further reconsideration or clarification. *Id.* at 121a-129a.

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[7] The Commission noted its concern "that direct credits to each customer's bill would be more expensive than providing a

3. The court of appeals affirmed. Pet. App. 1a-20a. The court first ruled that a prescription of a rate of return does not merely require that carriers target their rates to try to achieve that return, as petitioners contended, but also declares that any higher return "is unlawful and *shall not occur.*" *Id.* at 9a. The court explained that petitioners' view of the Commission's Section 205 authority focused only "on carriers' subjective efforts, not on future events," and that the Commission's objective view is a more reasonable construction of the statute: "The Commission's chief concern in issuing prescriptions is protecting just and reasonable rates, not policing carriers' states of mind." Pet. App. 9a. Indeed, the court pointed out that, in *Nader* v. *FCC*, it had made clear that a rate of return prescription is no less binding than a rate prescription: the order at issue in *Nader* had " 'the prospective effect of a prescription, thus *limiting the utility to that return.*' *Nader, supra,* 520 F.2d at 202 (emphasis added)." Pet. App. 10a. Hence, while AT & T was required to target its rates to achieve the prescribed 9.5 percent rate of return, it was also forbidden actually to earn more than the 10 percent rate that included the .5 percent buffer, and was free to file adjusted rates as necessary to avoid that result.

Turning to the question of remedy, the court of appeals, after stating without explanation that Section 204 does not apply to this case, held that the Commission had the authority under Section 4(i) of the Communications Act to enforce its rate of return prescription by requiring the re-

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discount on future services," citing, among other things, comments that AT & T had filed. Pet. App. 112a & n.86.

The Commission pointed to the same set of practical difficulties in explaining why it chose the mechanism of a future rate reduction rather than basing a restitution plan on the complex series of service-by-service accounting orders for specific services described in Appendix B of the initial decision. Pet. App. 112a n.87.

fund of AT & T's excessive earnings. Pet. App. 10a-15a.[8] That provision, the court noted (*id.* at 12a), is a "wide-ranging source of authority" that expressly authorizes measures " 'necessary in the execution of [the Commission's] functions.' " Here, the court pointed out: "In a strictly technical sense, the Commission's choice of remedy was absolutely necessary; without the reductions, the carriers in fact would not be limited to a return of 10% and the prescription would be violated." *Ibid.* In any event, the court said, "the Commission enjoys significant discretion to choose among a range of reasonable remedies, including refunds." *Ibid.* While the Commission might have taken other corrective action, the court concluded (*ibid.*), "the measure it adopted in this case was appropriate and reasonable."

The court rejected the suggestion that the refund order constituted retroactive ratemaking. The court explained simply: "There was not retroactive ratemaking here, because the carriers' obligations were set prospectively in 1976, when the Commission forbade AT & T from earning more than 10%." Pet. App. 13a. In requiring refunds for 1978 earnings in excess of the prescribed return, the court added, the Commission's order "merely recognized that the prior prescription had been violated and imposed a remedy for the violation." *Ibid.* The court agreed with the observation of the Commission in its brief that " '[t]he carriers are being required merely to give up what they never should have collected in light of the rate of return prescription.' " *Ibid.*

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[8] The court pointed out that "the order does not impose a refund in the classic sense of restitution" because "the reductions will accrue to the benefit of a different customer base from the base that contributed to AT&T's excessive earnings." Pet. App. 11a. The court held, however, that even if the remedy were properly characterized as a refund, "the order was well within the agency's statutory authority." *Ibid.*

The court also ruled that the Commission's order did not distort the regulatory balance between the interests of ratepayers and carriers. Pet. App. 13a-15a. First, the court pointed out that the 1976 rate of return prescription provided a measure of protection to carriers, as it protected them against any subsequent claim for refund on the ground that the rate of return was too high. *Id.* at 13a-14a (quoting *Nader* v. *FCC*, 520 F.2d at 205 n.25). Hence, if AT & T's cost of capital in the market had plunged below the prescribed rate of return, so that AT & T could offer an above-market return to attract capital, the Commission could not have sought a refund on that ground, but would have had to initiate a new proceeding to set a new, prospectively applicable rate of return. *Id.* at 14a.

Second, the court observed that, although the Commission required refunds for excessive rates of return but had not provided for carriers to be compensated for shortfalls in the rate of return, that asymmetry was not improper: carriers "are entitled only to earn an overall reasonable return," and they have an ample opportunity to do so. Pet. App. 14a. Thus, the court noted that carriers may at any time file new rates that are designed to achieve an adequate return; if a shortfall appears likely, carriers can propose an appropriate rate change. *Id.* at 14a, 15a. Indeed, in this respect, the refund/shortfall asymmetry reflects a carrier/ratepayer asymmetry: while carriers may file rate changes to protect themselves against shortfalls, ratepayers, the court explained, must rely predominantly on the Commission to protect them from unlawful charges. *Id.* at 14a.[9] Moreover, the court noted that the .5 percent buffer both in general made it easier for carriers to design rates targeted to produce more than the 9.5 percent figure but less than the 10 percent ceiling and, in this case, "more

[9] Ratepayers may also seek damages in certain circumstances pursuant to Sections 206-209 of the Act, 47 U.S.C. 206-209.

than adequately protected" AT & T's interests; during three of the five years in which the 1976 prescription was in effect, "the carrier's rates were designed precisely enough to produce a return above the ceiling but not so far above as to trigger a Commission remedy." *Id.* at 14a-15a. See note 6, *supra*. In short, the court concluded that the Commission's order did not "foster an impermissible balance between the interests of the carriers and those of the consumers." *Id.* at 13a.

Finally, the court of appeals rejected several challenges that petitioners do not renew in their petitions in this Court. Pet. App. 15a-20a. In particular, the court rejected the contention that, even if the refund order was lawful, it represented an abrupt reversal of prior policy and therefore could not be applied in the present case. The court explained that the order, far from reversing a prior policy, simpy responded to a new situation: "never before had a carrier exceeded a rate-of-return prescription." *Id.* at 16a. In any event, petitioners clearly could show no detrimental reliance on the non-enforcement of the prescription, as they conceded—indeed, insisted—that "they made every effort to comply with the prescription." *Id.* at 17a. In addition, the court of appeals rejected several of petitioners' challenges to the Commission's method of computing the carriers' liability. *Id.* at 18a-20a.

Judge Buckley dissented. Pet. App. 20a-39a. He did not argue, however, that the court erred in upholding the Commission's statutory authority to order the refund; in his view, the issue of statutory authority should not have been addressed. *Id.* at 21a. Rather, Judge Buckley would have set aside the Commission's order on the ground (not presented by petitioners in this Court) that the refund policy could not be applied to petitioners in any event because it represented an abrupt alteration of prior Commission policy. *Ibid.*

4. After the Commission issued its refund order in this case, it promulgated a general rule requiring all carriers to refund earnings they receive in excess of a previously established rate of return. In a decision rendered after the decision in the present case, the court of appeals, while reaffirming the present decision, set aside the Commission's general refund rule as arbitrary and capricious and remanded to the Commission. Pet. App. 141a-161a. Subsequently, the full court of appeals denied en banc rehearing of both cases. *Id.* at 133a-140a, 160a-166a. Judge Starr, joined by Judges Buckley and Williams, would have granted en banc review on the ground that the Commission's position, in this case as well as in the general rulemaking case, is inconsistent with the statutory scheme. *Id.* at 135a, 162a; see *id.* at 152a-159a.

ARGUMENT

The decision of the court of appeals does not warrant this Court's review. First, the court correctly held that the Commission had authority under Section 4(i) to enforce its earlier rate of return prescription by directing the carriers to pay back their excess collections; and that ruling does not conflict with any decision of this Court or of any other court of appeals.[10] Second, the court's affirmance of the Commission's order is independently justified on another ground, though one not relied on by the court of appeals—that the order in this particular case was authorized under Section 204 (in combination with Section 4(i)) of the

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[10] The law in the D.C. Circuit is " 'distressingly unsettled' " (88-1250 Pet. 20, quoting Pet. App. 135a) only in the limited sense that three of the judges have expressed their disagreement with the position adopted by two panels of the circuit. That position, in upholding the refund order here, follows logically from the earlier decision in *Nader* v. *FCC*, 520 F.2d at 202-206, and is not in conflict with any other decision of the D.C. Circuit.

Communications Act. Third, the continuing importance of the issue decided in the case is uncertain; and if the issue recurs, it is more appropriately reviewed in another case—particularly, in the context of the general Commission rulemaking on the refund question, currently on remand from the court of appeals.

1. The court of appeals correctly held that the FCC acted within its Section 4(i) authority in requiring the petitioner carriers to refund, through a reduction in future rates, the revenues AT & T collected in 1978 in excess of the maximum rate of return prescribed in 1976. Rate of return prescriptions are statutorily authorized. And a refund is clearly justified as a necessary means of enforcing such prescriptions.

a. The Commission undoubtedly has the authority, under Section 4(i) in conjunction with Section 205, to prescribe rates of return for the communications carriers it regulates. Section 205 permits the Commission to prescribe just and reasonable "charges" and "practices," and Section 4(i) broadly authorizes the Commission to make rules and to issue orders that are "necessary in the execution of its functions." Prescribing a rate of return allows the Commission to settle one of the critical issues that determine the lawfulness of particular rates, freeing both carriers and the Commission to focus on the other issues, such as the validity of elements of the rate base and of particular expenses. Accordingly, the D.C. Circuit expressly affirmed the Commission's authority to prescribe rates of return in 1975, *Nader* v. *FCC*, 520 F.2d at 203-206, explaining that such prescriptions are "necessary for the Commission to carry out its [ratemaking] functions in an expeditious manner" (*id.* at 204). Such authority is well within the broad authority that this Court has frequently recognized that ratemaking agencies have " 'to make the pragmatic adjustments which may be called for

by particular circumstances.' " *Permian Basin Area Rate Cases*, 390 U.S. at 776-777 (quoting *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942)). Such authority has been well established since 1975, and, indeed, petitioners do not openly challenge it here.

Any prescription issued under Section 205 has binding, coercive effect. Section 205 declares that a "charge" or "practice" prescribed under that provision is "to be thereafter observed"; and it further states that carriers "shall not thereafter publish, demand, or collect any charge other than the charge so prescribed, or in excess of the maximum * * * so precribed * * * and shall conform to and observe the regulation or practice so prescribed." 47 U.S.C. 205(a).[11] Prior to the 1976 prescription at issue here, moreover, *Nader* v. *FCC* made clear that a rate of return prescription had the binding effect of limiting the carrier to the prescribed rate of return (plus the buffer). 520 F.2d at 201-202. The 1976 prescription itself stated that AT & T's rate of return was " 'not to exceed' " the 10 percent enforcement-triggering ceiling. Pet. App. 6a. Hence, the court of appeals correctly held that the 1976 rate of return prescription was "no less binding" than a prescription of rates and had the " 'the force of a statute. . . . The carrier [was] bound to conform.' " *Id.* at 10a (quoting *Arizona Grocery*, 284 U.S. at 386).

An inherent and necessary corollary of the power to adopt binding rate of return prescriptions is the authority to enforce those prescriptions. This Court has often recog-

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[11] An order remains binding until superseded. See 47 U.S.C. 408 (FCC orders "shall continue in force for the period of time specified in the order or until the Commission or a court of competent jurisdiction issues a superseding order"). Cf. *Permian Basin Area Rate Cases*, 390 U.S. at 779 ("Nothing in [15 U.S.C. 717d(a)] imposes limitations of time upon the effectiveness of rate determinations issued under it; rather, the section provides that rates held to be just and reasonable are 'to be thereafter observed * * *.' ").

nized in the ratemaking context that " 'the width of administrative authority must be measured in part by the purposes for which it was conferred * * *.' " *FPC* v. *Texaco, Inc.*, 417 U.S. 380, 389 (1974), quoting *Permian Basin Area Rate Cases,* 390 U.S. at 776. Section 4(i), which serves as a "necessary and proper" clause (*North American Telecomm. Ass'n* v. *FCC*, 772 F.2d at 1292-1293), is by its terms designed to provide flexibility to the Commission in carrying out its statutory responsibilities. The enforcement of a prescription that is authorized under Section 205 is at the core of the enforcement authority that Section 4(i) grants the Commission. Again, petitioners do not expressly dispute that the Commission must be able to enforce its prescriptions.

As the court of appeals recognized, once the validity of rate of return prescriptions and the Commission's authority to enforce such prescriptions are accepted, the power to require refunds is readily justified as a tool to enforce a rate of return prescription. A refund is the most obvious means of ensuring that a directive establishing a maximum rate of return is not violated; indeed, a backward-looking remedial mechanism such as a refund is unavoidable where the prescription at issue is of a rate of return, because not until revenues are actually collected can it be determined whether the carrier actually exceeded the prescribed rate of return.[12] Thus, the court of appeals in

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[12] If the rates themselves are prescribed, a refund mechanism is necessary if the carrier actually charges in excess of the prescribed rates. Pet. App. 13a. Similarly, if the rates are allowed to go into effect but not found lawful by the Commission in advance, then a refund may be a necessary means of enforcing a subsequent determination of lawful rates. See 47 U.S.C. 204 (expressly authorizing refunds). If a carrier in fact charges the rates found lawful and prescribed by the Commission in advance, then there is no inherent justification for a backward-looking review of actual collections. Accordingly, because carriers' rates must be published and adhered to (47 U.S.C. 203), the

this case stated that the Commission's choice of the refund remedy, in "a strictly technical sense," was "absolutely necessary," because otherwise "the carriers in fact would not be limited to a return of 10% and the prescription would be violated." Pet. App. 12a.[13]

In any event, the FCC "enjoys significant discretion to choose among a range of reasonable remedies." Pet. App. 12a; *Nader* v. *FCC*, 520 F.2d at 203; see *General Telephone Co.* v. *United States*, 449 F.2d 846, 865 (5th Cir. 1971) (courts "must give deference to the choice of remedy selected by the agency," which should be upheld if it is "reasonably calculated to effectuate the policies of the Communications Act"). Refunds are well within that range. Indeed, compensatory remedies are expressly provided for in other sections of the Communications Act, 47 U.S.C. 204, 206, 209, and a refund is a well-established remedial device in utility regulation generally. See, *e.g.*, *Permian Basin Area Rate Cases*, 390 U.S. at 825-828; *FPC* v. *Tennessee Gas Transmission Co.*, 371 U.S. at 150-155.[14]

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issue of refunds, outside the Section 204 context, became significant only after the Commission began in 1972 to prescribe carriers' rates of return rather than only their rates.

[13] Petitioners in No. 88-1249 (at 11 n.15) state that the Commission's remedy "was to order that the rates on file be retargeted to the prescribed return." That argument ignores the fact that the Commission already had issued an order—the rate of return prescription—that had been violated. Nothing in the statutory scheme supports the suggestion that the only enforcement tool for violation of an agency order is to issue another order that may itself be violated.

[14] It would be inconsistent with the longstanding approach to the interpretation of the broadly worded ratemaking statutes—indeed, it would stand that approach on its head—to suggest that the Commission, when choosing a means of enforcing a form of order that is authorized by, though not specifically mentioned, in the statute, is forbidden to adopt remedies that are specifically provided for elsewhere in the statute. Cf. *Wisconsin* v. *FPC*, 373 U.S. 294, 309

b. Contrary to petitioners' contention, the requirement that they refund earnings in excess of the prescribed maximum return in no way violates the rule against retroactive ratemaking. The reason is simple: as the court of appeals explained, there was no retroactive ratemaking here, because the obligation being enforced was set prospectively in 1976 when the FCC issued its rate of return prescription. Pet. App. 13a. The refund order merely imposed a remedy for the carriers' violation in 1978 of the duty that was imposed in 1976. *Ibid.*

For that reason, petitioners' assertion that the decision below conflicts with numerous decisions concerning retroactive ratemaking is incorrect. See 88-1249 Pet. 13-18; 88-1250 Pet. 11-16. None of those decisions involved the situation that is at issue in this case—agency action enforcing an existing, prospectively defined prescription, let alone a rate of return prescription. Nothing in those decisions forbids a ratemaking agency's use of a refund to enforce, in a practical, administratively convenient manner, a valid, prospective agency order.[15]

Similarly, the Commission's choice of remedy to enforce its rate of return prescription does not disturb the balance between the interests of carriers and customers that Congress has established in the Communications Act. Of course, the Commission order must be judged on the basis of the provisions of the statute, not on the basis of an

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(1963) ("to declare that a particular method of rate regulation is so sanctified as to make it highly unlikely that any other method could be sustained would be wholly out of keeping with this Court's consistent and clearly articulated approach to the question of the Commission's power to regulate rates").

[15] The prospective nature of the FCC's action here is underscored by the fact that it did not order refunds by the independent (*i.e.*, non-AT & T) telephone companies, because the agency had not prescribed a rate of return limitation for those companies. Pet. App. 117a-118a & n.108.

idealized structure that imposes one particular vision of alleged "symmetry" that is not expressed in the statute itself. As we have shown, the refund order is authorized by the statute. In any event, as the court of appeals concluded, the Commission's order properly respects the statutory balance of carrier and ratepayer protection. Pet. App. 15a.

First, the Commission permitted AT & T a margin of .5 percent above the prescribed just and reasonable level of 9.5 percent, recognizing the imprecision of ratemaking and providing the carriers an incentive for efficiency. Only when—and to the extent that—AT & T exceeded both the 9.5 percent prescription and the .5 percent margin did the Commission require a refund. AT & T thus had ample room to set rates that were designed to achieve the authorized rate of return without fear of refunds caused by minor forecasting errors.[16]

Second, AT & T had an adequate opportunity to seek relief from anticipated shortfalls. If it appeared likely that the rates established by AT & T would be inadequate to achieve the prescribed return, AT & T could have filed tariff revisions. See 47 U.S.C. 203. On a proper showing, the Commission would have allowed such revisions to become effective promptly. As the court of appeals noted, AT & T presumably had every incentive to seek such revisions. Pet. App. 18a. And the Commission, having set a

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[16] In the general rulemaking proceeding, the court of appeals invalidated the Commission's general refund rule, explaining that the present case was different because here the Commission provided " 'ample protection for the carriers' interests.' " Pet. App. 149a-151a. The court also observed that the validity of the refund rule depended critically on whether the buffer was large enough so that expected swings in earnings deviated from the authorized rate of return by no more than that amount. *Id.* at 147a n.4. For AT & T during 1976-1980, of course, that was so, with the exception of 1978.

fair rate of return, reasonably could rely on AT & T to protect itself against a shortfall.[17]

Third, AT & T was always protected against the possibility that the Commission would order a refund on the ground that the prescribed rate of return was too high. Thus, if the cost of capital had fallen in 1977—after the FCC's prescription order had become effective—so that AT & T's achieved return of 9.59 percent in that year had been far above a level reasonably necessary to attract investment, the Commission would have been foreclosed by its prescription order from requiring a refund on that basis. Pet. App. 13a-14a (citing *Nader* v. *FCC*, 520 F.2d at 205 n.25). The Commission would have had to initiate and to complete a proceeding to revise its prescription order prospectively to eliminate that protection from AT & T

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[17] The record in this case does not support a finding that AT & T failed to achieve its authorized rate of return during any period of time in which the prescription was in effect. During the five years in which the 9.5 percent prescription was in effect, AT & T's rate of return averaged 9.69 percent—well above the prescribed level. Pet. App. 14a. Petitioners allege that there was a shortfall in 1976, but their sole support for that contention is that AT & T's earnings in that year were 9.25 percent. *E.g.*, 88-1250 Pet. 6, 7, 15-16. As noted above (note 6, *supra*), AT & T's authorized rate of return during the first two months of 1976 was only 8.5 percent. Because AT & T was not authorized to earn 9.5 percent throughout 1976, its failure to achieve a 9.5 percent return in 1976 does not establish a shortfall.

In any event, AT & T had an opportunity to earn the prescribed level (plus the margin) by filing rates and conducting its business. Customers, by contrast, had no choice but to pay the tariffed rates. It is hardly unfair to a carrier, even if a shortfall were shown, to disallow a second opportunity to achieve the prescribed level of earnings. See *FPC* v. *Tennessee Gas Transmission Co.*, 371 U.S. at 153, 150-155 (company must shoulder hazards incident to its action in filing rates, "including not only the refund of any illegal gain but also its losses where its filed rate is found to be inadequate").

and to lower its prescribed ceiling to the level justified by current conditions.[18]

Finally, the provisions of the statute are not perfectly symmetrical; indeed, they embody a distinction between carriers and ratepayers that the refund order of the Commission reflects. Pet. App. 14a. Thus, while carriers propose their own rates, and may seek increases when appropriate, ratepayers do not have a comparable power of initiation: they must generally rely on the Commission itself for protection. The refund order assists in that protection. Indeed, the Commission's order is entirely in keeping with the provisions of the statutory scheme that expressly permit recovery from a carrier for violations of a duty under the Act. *E.g.*, 47 U.S.C. 204, 206-209. In short, requiring AT & T to refund earnings it received in violation of outstanding prescription orders did not disturb the statutory balance of interests, but rather vindicated that balance.[19]

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[18] The Commission in 1981 prescribed a rate of return for AT & T of 12.75 percent, with a buffer of .25 percent. *AT & T*, 86 F.C.C.2d 221 (1981), aff'd, *United States* v. *FCC*, 707 F.2d 610 (D.C. Cir. 1983). Subsequently, economic circumstances changed significantly in a direction indicating that the rate of return (and thus the rates) should be lower. AT & T, however, was permitted to earn a rate of return of 13 percent under the 1981 prescription order until the FCC superseded that order with a new one. The Commission did not do so until 1986. *Authorized Rates of Return for the Interstate Services of AT&T Communications and Exchange Telephone Carriers* (CC Docket No. 84-800 Phase III), FCC 86-354 (released Aug. 25, 1986).

[19] Judge Starr, in his concurrence in the case concerning the Commission's general rulemaking on refunds, argued (Pet. App. 157a-158a) that the 1933 amendment of Section 15a of the Interstate Commerce Act (ICA), just prior to Congress's enactment of the Communications Act of 1934, shows that recapture of recoveries in excess of a prescribed rate of return is inconsistent with congressional intent behind the 1934 Act. But, even aside from the danger of relying heavily on a different statutory scheme for an industry with a different

2. The court of appeals' holding affirming the Commission's refund order in this particular case is also correct on a ground not adopted by the court of appeals. Petitioners acknowledge, as Section 204 expressly states, that the Commission has authority to require carrier refunds of excess charges if those charges were suspended, allowed to take effect pending an investigation, and subjected to an accounting order. 88-1249 Pet. 4; 88-1250 Pet. 13 n.19, 16. Contrary to petitioners' suggestion, however (see note 5, *supra*), that is precisely what the Commission did with respect to the AT & T rates that are at issue in this case. Accordingly, Section 204 (in conjunction with Section 4(i)) independently supports the Commission's refund order and the court of appeals' judgment. While this Court's review of the court of appeals' holding is not for that reason precluded, the existence of an independent ground supporting the judgment counsels against review.

a. The rates that resulted in excessive revenues in 1978 were set forth in tariff revisions filed by AT & T on Jan-

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history and different problems, the ICA amendment does not have the suggested significance. The provision that Congress replaced (a) established a single fair rate of return for all railroads in the country or in a particular designated group, based on the aggregate value of those railroads' property, and (b) required each railroad then to place into certain contingency reserves any earnings that exceeded that rate of return, regardless of the railroad's individual circumstance. See 41 Stat. 488-491. The provision did not set a carrier-specific rate of return and then require disgorgement of earnings that exceeded that rate. The House Report (H.R. Rep. No. 193, 73d Cong., 1st Sess. 27-30 (1933)), in explaining why the provision should be repealed, focused principally on the provision's grouping together of all railroads and the fluctuating conditions of individual railroads. Only one remark (quoted by Judge Starr (Pet. App. 158a)) concerns the incongruity of permitting carriers to earn more than they ought to earn and recapturing the excess, and that remark must be read in context, recognizing that the rate of return maximum at issue was not carrier-specific.

uary 19, 1976, to implement the Commission's rate of return prescription. *AT & T*, 58 F.C.C.2d 1. Exercising its authority under Section 204(a), the Commission suspended those tariff revisions for one day and set them for investigation. 58 F.C.C.2d at 4-5. The Commission required AT & T to "maintain an accounting of the revenues derived under these revised tariffs, for possible refund upon resolution of the lawfulness thereof." *Id.* at 4.[20]

The Commission had decided on the rate of return component of a just and reasonable rate, but it set for investigation numerous other issues that had to be resolved before the rate itself could be determined—*e.g.*, investments, cash expenses, and non-cash expenses. 58 F.C.C.2d at 4. Hence, as the order expressly noted, and contrary to petitioners' suggestions (see note 5, *supra*), the question whether the proposed rates actually would produce the fair rate of return that the Commission had prescribed was still open and part of the investigation. *Ibid.* The Commission cited Sections 204, 205, and 4(i) as sources of its authority to suspend, investigate, and require an accounting in this case. 58 F.C.C.2d at 5. The 1978 rates, therefore, were subject to refund under Section 204 to the extent they produced an actual rate of return that was unlawful (under the rate of return prescription) and, hence, was "not justified" (47 U.S.C. 204(a)).

The 1984 order directing the refund of such unjustified revenues was issued by the Commission while the 1976 accounting order, as well as various other accounting orders applicable to AT & T's 1978 rates, were still in effect. See Pet. App. 73a-85a (initial order, Appendix B). And, although the order directed the refund of the excess through a future rate reduction, it was a proper exercise of

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[20] See also Pet. App. 81a-93a (initial order, Appendix B) (pointing out that several other accounting orders with respect to AT & T's interstate services were in effect during 1978).

the Commission's Section 204 authority. Thus, the refund was "to the persons in whose behalf such amounts were paid" (47 U.S.C. 204), considered collectively—namely, to the (ever-changing) class of customers. Such an application of Section 204's refund authority is well within the Commission's Section 4(i) authority to make its powers effective, for as the Commission itself explained based in part on AT & T's comments (Pet. App. 53a-54a, 111a-112a), there would be insuperable obstacles to an individualized refund plan applicable to the customer base from years earlier. Plainly, Section 4(i) authorizes the Commission to give effect to Section 204's refund authorization without adopting a self-defeating plan that would waste a large part of the refund in administrative expenses (or a plan that imposed those expenses, in addition to the refund, on the carrier). Indeed, the accounting order imposed on AT & T itself required only class-wide accounting for this very reason (58 F.C.C.2d at 4-5)—and AT & T, of course, did not object—yet no individualized refund is possible based only on class-wide accounting.[21]

b. Although the court of appeals stated that Section 204 did not apply in this case (Pet. App. 12a), the court gave no explanation. For the reasons we have set out, the court's statement is incorrect: Section 204 supports the Commission's ruling in this case. And, although the Commission did not expressly rest its 1984 order on Section 204, there is no barrier to upholding the ruling on that basis.

Contrary to petitioners' suggestion (88-1250 Pet. 14 n.19), never in this proceeding has the Commission "disclaim[ed]" reliance on Section 204. Tellingly, peti-

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[21] Although large-scale refunds are rare, this is hardly a revolutionary refund mechanism in ratemaking. See, *e.g.*, *FPC* v. *Tennessee Gas Transmission Co.*, 371 U.S. at 154-155 & n.9; *Bebchick* v. *PUC*, 318 F.2d 187 (D.C. Cir.), cert. denied, 373 U.S. 913 (1963).

tioners cite no such disclaimer. Indeed, the Commission did not expressly claim exclusive reliance on Section 205 in conjunction with Section 4(i). See Pet. App. 59a. And the fact that the rates at issue were subject to an accounting order under Section 204 was repeatedly relied on at all stages of the present proceeding.

Thus, after AT & T had reported that its earnings in 1978 had exceeded a 10 percent rate of return, a petition by several citizens groups in July 1979 urged the Commission to require a refund, pointing out that AT & T's tariff filing had been subjected to an accounting order. See Pet. App. 40a n.1, 67a. The 1979 notice of inquiry that led to the refund order described the 1976 accounting order and noted that it had contemplated the possibility of refunds (75 F.C.C.2d at 415 & n.6), undertook to act on the citizens groups' petition for enforcement of the accounting order (*id.* at 414 n.5), and cited Section 204 as one of the statutory provisions that were relevant to its inquiry (75 F.C.C.2d at 416-417). In the 1984 order requiring petitioners to disgorge the excessive 1978 earnings, the Commission again referred to the citizens groups' petition for enforcement of the accounting order (Pet. App. 40a n.1) and explicitly granted that petition "to the extent stated in the rulings and procedures that have been adopted herein" (*id.* at 59a). In the same order, in rejecting the "retroactivity" argument that the rates at issue had previously become lawful, the Commission relied centrally on the fact that the 1978 rates had never been accepted as lawful, referring for elaboration to Appendix B, which explained that the rates were subject to numerous accounting orders, including the 1976 accounting order adopted under Section 204. *Id.* at 57a (referring to *id.* at 73a-85a (Appendix B)).[22]

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[22] The Commission stated in its reconsideration decision that it had not relied on "the accounting orders that are discussed in Appendix B of the *Restitution Decision* in formulating the restitution mechanism."

In its reconsideration order, the Commission again cited Appendix B in rejecting both the retroactivity argument and the argument that the rate of return prescription did not have binding effect. *Id.* at 102a n.55, 104a n.60.

In defending its order in the court of appeals, the Commission's brief did not expressly rely on Section 204. Nor did it disclaim reliance on that provision or claim exclusive reliance on Section 205.[23] At oral argument, moreover, the Commission, while acknowledging that this was not the agency's primary rationale for its action, contended "that the Commission did in fact exercise its section 204 powers here by suspending the rates, by setting up an accounting order, and that the accounting order remained valid in 1978 and that this is from that perspective a very traditional rate refund." Transcript of oral argument (Oct. 30, 1986), at 35-38.

In these circumstances, the refund order of the Commission may properly be upheld under Section 204 (in conjunction with Section 4(i)). To be sure, under *SEC* v. *Chenery Corp.*, 332 U.S. 194 (1947), a court may not uphold an agency ruling on any basis that was not relied on by the agency and that would require the court to substitute its own discretionary judgment for that of the agency. See *ICC* v. *Brotherhood of Locomotive*

Pet. App. 112a n.87. As we have noted, however (see note 7, *supra*), that statement merely explained why the Commission was adopting a discount in rates for the future instead of a customer refund plan based on the series of accounting orders described in Appendix B. It was not a disclaimer of reliance on Section 204.

[23] The brief (at 4-5 n.4) noted that the rates at issue were subject to an accounting order. It also stated (at 28), however, that "[i]f the Commission were to accept the position of the carriers in this case that it had no refund power except under Section 204 of the Act, the carriers would be free to ignore not just this rate of return prescription, but any prescription." To the extent that that statement overlooks the existence of a Section 204 accounting order in this case, it is mistaken.

Engineers, 107 S. Ct. 2360, 2368 (1987). But, in addition to the significant reliance actually placed on Section 204 by the Commission here, the *Chenery* principle does not preclude upholding the Commission refund order in this case under Section 204. If there is a valid statutory basis for an agency decision, the decision should be upheld on that basis—even if the agency relied on an incorrect statutory basis—if it is clear that the agency would have made exactly the same decision had it not relied on the incorrect statutory authority. See *Massachusetts Trustees* v. *United States,* 377 U.S. 235, 246-247 (1964). Here, it is beyond doubt that the Commission refund order would be the same under Section 204 or Section 205, and no discretionary element of the decision would be affected by which precise statutory basis supported the result. Plainly, the Commission would not abandon the objective of recouping AT & T's excessive 1978 earnings if it had to rely on Section 204, which does, after all, speak expressly of refunds. Accordingly, there is an alternative ground to support the court of appeals' judgment.

3. Even aside from the correctness of the court of appeals' holding and the existence of an alternative ground to support the judgment, this case does not merit review. First, the continuing significance of the question of refunds to enforce rate of return prescriptions is at present uncertain. The Commission recently adopted a system of "price caps" derived from current rates to replace the scheme of rate of return regulation for AT & T, and it has proposed a similar system for local exchange telephone companies. See FCC News Report No. DC-1379, *Commission Adopts Incentive Regulation for Dominant Carriers,* (Mar. 16, 1989). Such a system would eliminate or reduce substantially the Commission's primary reliance on rate of return prescriptions as a means of ratemaking, at least for AT & T. To that extent, it would effectively moot the refund issue.

If, on the other hand, the Commission pursues a policy of enforcing rate of return prescriptions through refunds (without a Section 204 accounting order), then there will be a better vehicle for reviewing that policy—one that does not involve a clear Section 204 basis for the policy. Indeed, the Commission is currently considering what steps to take on remand from the court of appeals' decision (Pet. App. 141a-159a) setting aside its general rule establishing procedures for the implementation of such a policy. If the Commission promulgates a new rule, a challenge to such a rule would provide a more suitable case for review of the refund question, as it would involve a more complete record on pertinent issues (such as the proper relation between rate of return excesses and shortfalls).

In short, although we believe that the refund issue, having been correctly resolved by the court of appeals, does not warrant this Court's review, there will be more appropriate occasions to review the question if it proves to be of continuing importance. Nor is there any equitable imperative for review of this particular case. In addition to the fact that the Section 204 accounting order put AT & T on ample notice of the possibility of a refund and independently supports the ruling, the present case merely involves the disgorgement of revenues that petitioners had no right to receive in the first place without violating the outstanding prescription order.

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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Nos. 88-1249 and 88-1250

In the Supreme Court of the United States

OCTOBER TERM, 1988

SOUTHERN BELL TELEPHONE & TELEGRAPH CO., ET AL.,
PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

NEW ENGLAND TELEPHONE AND
TELEGRAPH COMPANY, ET AL., PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

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*ON PETITIONS FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT*

SUPPLEMENTAL MEMORANDUM FOR THE FEDERAL RESPONDENTS

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In the Supreme Court of the United States

OCTOBER TERM, 1988

No. 88-1249

SOUTHERN BELL TELEPHONE & TELEGRAPH CO., ET AL., PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

No. 88-1250

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, ET AL., PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

SUPPLEMENTAL MEMORANDUM FOR THE FEDERAL RESPONDENTS

In its amicus brief in support of petitioners, the Communications Satellite Corp. (COMSAT) correctly observes (at 4) that in 1988 the Federal Communications Commis-

sion ordered COMSAT to refund amounts collected in excess of a previously prescribed rate of return (*COMSAT*, 3 F.C.C. Rcd 2643 (1988)) and that the Commission there relied on the court of appeals' ruling in the present case to reject the claim that the refund order was beyond the Commission's statutory authority (*id.* at 2645). That Commission decision is currently on review in the D.C. Circuit, which has deferred briefing pending the disposition of the petitions in these cases. We file this brief supplemental memorandum in response to COMSAT's amicus submission, since we had overlooked the *COMSAT* case in preparing our brief in opposition to the petitions for a writ of certiorari in these cases.

Notwithstanding the Commission's reliance in *COMSAT* on the ruling at issue here, the pendency of the *COMSAT* decision in the court of appeals does not undermine our submission that the continuing importance of the present ruling is insufficient to warrant review. First, besides *COMSAT*, there is no other outstanding decision raising the refund issue decided by the court of appeals here. Second, in *COMSAT* itself, as in the present cases, the Commission ordered refunds only with respect to rates that took effect subject to investigation and were made subject to an accounting order under Section 204.* See 3 F.C.C. Rcd at 2644, 2645-2647; *COMSAT*, 2 F.C.C. Rcd 3706, 3708 (1987) (proposing refund order). Third, COMSAT's appeal from the Commission's *COMSAT* decision may well raise other issues that might make it unnecessary for the court of appeals to consider the Commission's refund

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**COMSAT*, CC No. 80-634, Mem. Op. & Order (released Aug. 2, 1984) (allowing tariff changes to take effect subject to investigation with issues to be designated in subsequent order, citing Section 204); *COMSAT*, CC No. 86-634, Mem. Op. & Order (released Nov. 8, 1985) (designating issues and requiring accounting under Section 204(a)).

authority at all. Thus, the question presented by petitioners here—the Commission's refund authority outside the Section 204 context—might not be or have to be resolved by the court of appeals on review of the *COMSAT* decision, and there is no other pending case raising the issue.

Accordingly, for the reasons set forth in our brief in opposition, the present petitions should be denied.

Respectfully submitted.

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Acting Solicitor General

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v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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IN THE

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NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, *et al.*,
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v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

PETITIONERS' REPLY BRIEF

The petition showed that the FCC's rate-of-return prescription/refund scheme violates the "rule against retroactive ratemaking" that preserves the balance between utility and customer interests established in the Communications Act and similar federal regulatory statutes. Review should be granted because the decision below, upholding the concededly "asymmetric" FCC scheme that imposes upon carriers all of the risks inherent in designing rates to achieve a specified rate of return, conflicts with numerous decisions of this Court and the courts of appeals.

Respondents do not directly challenge this central argument of the petition. Instead, they attempt to avoid the issue by making three unfounded contentions.

1. Respondents describe Section 4(i) of the Communications Act as a " 'necessary and proper' " clause (Opp. 17, *quoting North American Telecommunications Ass'n* v. *FCC*, 772 F.2d 1282 (7th Cir. 1985)), that enables the FCC to select any remedy that it wishes to enforce a prescription order. But, as we showed in the petition (pp. 18-19) and as the Seventh Circuit observed in that case, 772 F.2d at 1292, "Section 4(i) is not infinitely elastic;" "as its language makes clear," it cannot be used "to contravene another provision of the Act." Thus, as demonstrated in the petition, the FCC cannot rely upon the general authority granted by Section 4(i) to contravene Section 205(a) and the other provisions of the Communications Act which codify the rule against retroactive ratemaking.[1]

Respondents next suggest (Opp. 17-18) that resort to Section 4(i) to sustain a refund order is "necessary" to enforce a rate-of-return prescription. But, as Judge Starr observed in his separate opinion in the *Rulemaking Case*, the FCC can enforce such a prescription order by "summarily . . . reject[ing] any tariff revision designed to achieve more than the prescribed rate of return." Pet.

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[1] The D.C. Circuit recently rejected the contention that Section 16 of the Natural Gas Act ("NGA"), which corresponds to Section 4(i), "functioned as a sort of statutory equivalent of the Constitution's 'necessary and proper' clause." *Public Service Comm'n of New York* v. *FERC*, 866 F.2d 487, 491 (D.C. Cir. 1989). Noting that the NGA "sets up a carefully balanced mechanism for the [FERC's] supervision of natural gas company rates," *id.* at 488, the court concluded that there was "no basis for reading § 16 as overriding the balance achieved by §§ 4 and 5, and [found] FERC's expansive view of its § 16 powers to be contrary to the purposes of the Act." *Id.* at 492.

See also, Louisiana Public Service Comm'n v. *FCC*, 476 U.S. 355, 370 (1986) ("we would be disinclined to favor the provision declaring a general statutory purpose, as opposed to the provision which defines the jurisdictional reach of the agency formed to implement that purpose").

App. 159a. In addition, as Judge Starr also noted, the Commission has the power under Section 205 "to prescribe just and reasonable charges *for the future*" if, contrary to its and the carrier's original expectations, events subsequent to the filing of the rates lead to higher earnings. *Id.* at 157a (emphasis in original). Thus, it is not necessary to enforce a rate-of-return prescription by refunds that violate the rule against retroactive ratemaking and distort the balance established in the Communications Act.

Respondents argue (Opp. 18) that refunds are accepted regulatory techniques and that the courts should not restrict agency discretion to order them. However, Section 204(a) specifically limits refunds only to carefully defined circumstances, which as shown below, pp. 5-6, are not present here. Indeed, as noted in the petition (p. 16), the fact that Congress authorized refunds only under Section 204(a) and specifically failed to authorize them to enforce prescription orders under Section 205, in and of itself exposes the FCC's error in ordering a refund in this case.

Respondents seek to obscure the "asymmetry" inherent in a scheme that forces carriers to suffer inadequate earnings, while allowing customer refunds for excess earnings, by contending that a carrier can file rate increases to protect itself from "anticipated shortfalls" in earnings. (Opp. 20; *see also*, *id.* at 12, 22). But this argument simply ignores the uncertainties inherent in rate design. As shown in the petition (p. 11), it is not always possible for carriers to anticipate shortfalls because they cannot predict with precision the actual return that will be earned.[2] This point is vividly illustrated by

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[2] Respondents unwittingly concede this point when they state (Opp. 17) that "not until revenues are actually collected can it be determined whether the carrier actually exceeded the prescribed rate of return."

Bell's 1976 results, when its newly-filed rates produced earnings below the prescribed rate of return.[3] Because carriers cannot accurately forecast all of the myriad factors that will affect their return, the practical effect of the Commission's refund scheme is to impose all of the risks of shortfall on the carriers, upsetting the balance of customer and carrier interests established by the rule against retroactive rate-making.

Respondents have never disputed that Bell's rates were set in a good faith effort to achieve the prescribed rate of return. Rather, they suggest that the carrier's state of mind is irrelevant (Opp. 10, *quoting* Pet. App. 9a). But, as noted in the petition (p. 17), the sole provision in the Act that expressly provides a remedy for violations of prescription orders is Section 205(b), which requires a showing of "willful" violation of such orders. Thus, under Section 205(b), if the FCC had determined that Bell knew its rates would generate returns above the prescribed level, it could have imposed substantial fines to enforce that prescription. However, the FCC has never found nor suggested that Bell knew or should have known, on January 1, 1978, that its then two-year-old rates would produce a return above 10% for the coming year.

2. The Solicitor General all but concedes that the stated grounds for the Commission's action and the court of appeals' decision are suspect. Thus, in addition to pressing the Section 4(i) argument, he contends (Opp. 23-28) that the FCC and the court below could have

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[3] Respondents seek to explain Bell's inadequate earnings in 1976 on the ground that its new higher rates premised upon the 9.5% return prescription were effective for only the last 10 months of that year. (Opp. 21 n.17). However, as shown in the petition (p. 6, n.9), Bell earned significantly less than 9.5% during the last 10 months of 1976.

relied on Section 204 of the Act to support the refund order.

The Solicitor General acknowledges that the FCC "did not expressly rest its [refund] order on Section 204" (Opp. 25), that the FCC's brief in the court of appeals "mistaken[ly]" argued that if the FCC "had no refund power except under Section 204 . . . carriers would be free to ignore . . . this rate of return prescription" (Opp. 27 n.23), and that the court of appeals stated "that Section 204 did not apply in this case" (Opp. 25).[4] However, noting that several groups petitioning for refunds had pointed out that Bell's rates had been the subject of an accounting order (Opp. 26), the Solicitor General now asserts that Section 204 provides an independent statutory predicate for the refund order.

The FCC was right to disavow reliance on Section 204 below. As the Solicitor General concedes (Opp. 24), the FCC had decided the rate of return issue prior to its issuance of the accounting order. Accordingly, the ensuing investigation and related Section 204 accounting did not focus on whether Bell's rates were designed to yield the prescribed rate of return, but instead on other issues, such as whether Bell's costs were allowable and properly calculated. *See In the Matter of AT&T*, 58 F.C.C.2d 1 (1976).[5] Thus, the investigation and accounting order did not pertain to the rate of return issue. *See* Pet. pp. 13-14 n.19.

In any event, Section 204 could not have been employed to order refunds in the manner now proposed by the Solicitor General. The focus of any investigation and

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[4] *See also*, Judge Buckley's statement, in his dissenting opinion in the *Refund Case*, that "the agency did not see fit to pursue the Section 204 remedy in this case." Pet. App. 29a.

[5] For example, if during the investigation the FCC had determined that Bell erred in the calculation of its costs, the FCC could have ordered refunds to correct that error irrespective of its impact upon Bell's return.

accounting under Section 204 and comparable provisions of other regulatory statutes is whether the rates were lawful when filed. Thus, an agency is authorized under Section 204 to investigate and order refunds where a carrier has " 'file[d] . . . a tariff *designed* to produce a rate of return in excess' " of the prescribed rate of return. *Nader v. FCC*, 520 F.2d 182, 205 n.25 (D.C. Cir. 1975), *quoting In the Matter of AT&T*, 51 F.C.C. 2d 619, 626 (1975) (emphasis added). But an agency cannot order refunds because years later the carrier's initially correct estimates of its costs, revenues, rate base, and other factors governing its rates no longer produce the return that they were designed to yield. *See, e.g., Delmarva Power & Light Co.* v. *FERC*, 770 F.2d 1131, 1138-39 (D.C. Cir. 1985) (Natural Gas Act); *Indiana & Michigan Municipal Distributors Ass'n* v. *FERC*, 659 F.2d 1193, 1197-98 (D.C. Cir. 1981) (Federal Power Act).

Here, Bell's rates were lawful when filed; for the first two years in which these rates were in effect they yielded earnings well within the range permitted by the FCC's prescription order. In these circumstances, an agency cannot use an accounting to conduct an open-ended inquiry and order refunds based on actual results reported three years after the rates were filed.[6]

3. Although respondents seek to minimize the impact of the decision below based upon pending or future proceedings at the FCC,[7] they do not deny that the principle

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[6] If the FCC's investigation determines that subsequent events have rendered existing rates unjust and unreasonable, Section 204 authorizes it to declare existing rates unlawful and to prescribe new rates for the future.

[7] Respondents contend (Opp. 28) that the FCC's recent adoption of "price cap" regulation for AT&T "would effectively moot the refund issue." We disagree. To begin with, the Commission has not adopted price cap regulation for any of the carriers that have petitioned this Court for certiorari and it does not even contemplate using such regulation for all carriers. At all events,

adopted by the D.C. Circuit in this case has broad applicability to all agencies that operate under regulatory regimes similar to that set forth in the Communications Act.[8]

Similarly, respondents seek to dismiss out of hand the numerous decisions that have applied the rule against retroactive ratemaking in a manner that would prohibit the type of action taken by the Commission here. In respondents' view (Opp. 19), those cases are inapposite because none involved agency enforcement of a rate-of-return prescription through a refund order. But that is precisely the point: Because the FCC's action is so clearly unauthorized, no other agency with comparable statutory authority has ever attempted to do what the FCC has done here.

Finally, there is no merit to respondents' assertion (Opp. 29) that the Court should await the outcome of the remand in the *Rulemaking Case* before resolving the statutory authority issue. As noted in the petition (p. 9), the *Rulemaking Case* endorsed the *Refund Case*, insofar as it upheld the FCC's authority to order refunds to enforce rate-of-return prescriptions, and that issue is not being revisited by the Commission on remand. In the meantime, the FCC has continued to order refunds for asserted violations of rate-of-return prescriptions in a

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the FCC still proposes to prescribe rates of return and it has not ruled out the imposition of retroactive refunds under a price cap regulatory regime.

[8] Respondents unsuccessfully attempt to limit the meaning of Judge Starr's statement, in his opinion dissenting from the denial of rehearing *en banc*, that the law in the D.C. Circuit is "distressingly unsettled" (Opp. 14 n.10). As Judge Starr's separate opinion in the *Rulemaking Case* makes clear (Pet. App. 154a-156a), the decision below upholding the FCC's refund order is contrary to other cases in this Court and in the D.C. Circuit applying the rule against retroactive ratemaking in a variety of regulatory contexts.

variety of contexts. *See* Brief of Amicus Curiae Communications Satellite Corp. at p. 4 and n.5. Thus, the question presented here is a pressing one that has great importance not only for the telecommunications industry, but also for the many other industries regulated by the federal government.

CONCLUSION

For the foregoing reasons and those set forth in the petition, the petition for a writ of certiorari should be granted.

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OCTOBER TERM, 1988

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Petitioners,

v.

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Respondents.

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, *et al.*,
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v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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MOTION FOR LEAVE TO FILE AND RESPONSE OF AMICUS CURIAE COMMUNICATIONS SATELLITE CORPORATION TO RESPONDENTS' SUPPLEMENTAL MEMORANDUM

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

No. 88-1249

SOUTHERN BELL TELEPHONE & TELEGRAPH COMPANY, *et al.*,
Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,
Respondents.

No. 88-1250

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, *et al.*,
Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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MOTION FOR LEAVE TO FILE RESPONSE OF AMICUS CURIAE COMMUNICATIONS SATELLITE CORPORATION TO RESPONDENTS' SUPPLEMENTAL MEMORANDUM

Communications Satellite Corporation ("COMSAT") respectfully moves for leave to file the attached pleading.

On April 3, 1989, COMSAT filed a brief as *amicus curiae* in support of the above-captioned petitions for writ of certiorari, and the federal government respondents filed their brief in opposition. Several days later, the federal respondents filed a supplemental memorandum responding to certain arguments made by COMSAT in its *amicus curiae* brief. That supplemental memorandum was not received by COMSAT or the petitioners until Friday, April 7th.

Upon reviewing this supplemental response, COMSAT concluded that it creates an erroneous impression about the issues raised in COMSAT's *amicus curiae* brief. The Supreme Court rules make no provision, however, for *amicus curiae* to respond to such a supplemental pleading. COMSAT asked the New England Telephone petitioners to file the attached pleading pursuant to Supreme Court Rule 22.6, but they declined to do so, although they do not oppose the filing of this pleading. Accordingly, COMSAT respectfully requests leave to file the attached response to the federal respondents' supplemental memorandum.

Respectfully submitted,

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RESPONSE OF AMICUS CURIAE COMMUNICATIONS SATELLITE CORPORATION TO RESPONDENTS' SUPPLEMENTAL MEMORANDUM

In their supplemental memorandum, the federal respondents argue that the pendency of the *COMSAT* rate

case [1] does not undermine their previous assertion that "the continuing importance of the present ruling is insufficient to warrant review" (Supp. Mem. at 2). Some of the stated assumptions upon which that argument rests are not valid.

First, while it is technically accurate to say that there is "no other outstanding decision raising the refund issue decided by the court of appeals," we pointed out in our papers that the Commission has continued to exercise its newly asserted statutory authority to require refunds even though it did not rely upon Section 204 of the Communications Act.[2]

Second, it is true that in *COMSAT*, as in the present case, the Commission imposed an accounting order. But even assuming for present purposes that the accounting order in *COMSAT* was valid,[3] it cannot properly be used in that case or in the present case to achieve the result sought by the Commission. The purpose of an accounting order under Section 204 is to enable an accounting at the end of the investigation of rates placed into effect during the investigation.[4] The salient point, however, is that the focus of the investigation is on whether the rates were excessive *when filed*. In other words, the agency is to determine whether the carrier included all of its

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[1] *Communications Satellite Corporation*, 3 FCC Rcd 2643, *appeal docketed*, No. 88-1243 (D.C. Cir. March 28, 1988).

[2] Brief of Communications Satellite Corporation as Amicus Curiae in Support of Petitioners at 4 n.5.

[3] COMSAT argued before the Commission and would press on appeal its view that, under the express terms of Section 204, an accounting order cannot be imposed when, as in the *COMSAT* case, the new tariffs reflected decreased rather than increased charges, and the new tariffs were not suspended.

[4] New England Telephone and Telegraph Company, *et al.*, Petitioners' Reply Brief at 6.

legitimate costs (and only the legitimate costs) under the rules or regulations then applicable and whether the other estimates upon which the rates were based were reasonable when made. It is quite a different matter to determine, based on subsequent developments, whether the estimates were in actuality borne out.

In the *COMSAT* case, as in the present case, the Commission did not dispute the reasonableness of the estimates upon which the filed rates were premised. Rather, it concluded after the fact that the rates were excessive because they produced earnings greater than had been reasonably estimated. That is the kind of retroactive ratemaking which the cases roundly condemn. This is why the present case clearly warrants exercise of the Court's certiorari review.

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Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF COMMUNICATIONS SATELLITE CORPORATION AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF COMMUNICATIONS SATELLITE CORPORATION AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

Communications Satellite Corporation ("COMSAT") respectfully submits this brief *amicus curiae* in support of the above-captioned petitions for writ of certiorari to review a decision of the United States Court of Appeals

for the District of Columbia Circuit. The decision is reported at 826 F.2d 1101 and is reprinted in Appendix A (1a-40a) to the petition filed by Southern Bell Telephone & Telegraph Co., *et al.*, and Appendix A (1a-39a) to the petition filed by New England Telephone and Telegraph Co., *et al.* Counsel for the parties have consented to the filing of this brief.

INTEREST OF AMICUS CURIAE

COMSAT is a private satellite communications corporation established pursuant to an Act of Congress, the Communications Satellite Act of 1962, 47 U.S.C. § 701 *et seq.* By the terms of that Act, COMSAT is deemed a common carrier under the Communications Act of 1934, 47 U.S.C. § 151 *et seq.* ("the Act"). As such, COMSAT is subject to rate regulation by the Federal Communications Commission ("FCC").

In January 1988, the FCC resolved certain issues in an investigation of COMSAT's rates by ordering COMSAT to refund to its customers revenues for past periods on the ground that such revenues represented earnings in excess of those permitted under a previously prescribed rate of return. In its order, the Commission expressly relied on the decision below to conclude that it had the statutory power to order such refunds. COMSAT has petitioned for review of that order in the D.C. Circuit, where briefing has been deferred pending the disposition of the petitions for certiorari in the instant case. COMSAT thus is directly affected by the decision of which review is now sought and has a strong interest in the ultimate resolution of the issues posed. COMSAT was an *amicus curiae* before the court below.

ARGUMENT

The court of appeals' holding has far reaching implications going beyond the specific refund obligation imposed by the FCC on AT&T and the regional Bell operating companies. Moreover, that holding is in direct conflict with the governing statute and long settled precedent interpreting it and analogous statutory schemes.

I.

As recognized by the judges who dissented from the denial of rehearing *en banc* by the court below, "the fundamental issue" presented here "is of manifest importance." [1] This case does not affect only the parties involved, nor can it be reduced to a dispute over $101 million. Rather, this case has important consequences for many of the communications common carriers regulated by the FCC and for a number of other regulated utilities as well.

This case is the first in the long history of FCC ratemaking in which the FCC has sought to order refunds for past periods without adhering to the specific provisions of its enabling statute.[2] The importance of this case is underscored by the fact that since the FCC's decision in this case, it has on several occasions sought to extend its newly asserted statutory power. As noted by petitioners,[3] soon after the FCC imposed the refund obligation on the Bell companies for alleged past excess earnings challenged in this case, it initiated a rulemaking

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[1] Southern Bell Telephone & Telegraph Co., *et al.* Appendix ("Southern Bell App.") at 44a; New England Telephone and Telegraph Co., *et al.* Appendix ("New England App.") at 135a (Starr, J., joined by Buckley and Williams, J.J., dissenting).

[2] *See* Southern Bell Telephone & Telegraph Co., *et al.* Petition for a Writ of Certiorari ("Southern Bell Pet.") at 4-7; New England Telephone and Telegraph Co., *et al.* Petition for a Writ of Certiorari ("New England Pet.") at 10.

[3] Southern Bell Pet. at 7; New England Pet. at 8-9.

proceeding in which it ultimately adopted a rule requiring all dominant domestic common carriers to refund automatically any earnings in excess of their previously prescribed rate of return—regardless of whether the FCC had investigated the rates that ultimately produced those earnings prior to their going into effect or whether the FCC had imposed an accounting order as provided for in Section 204(a) of the Act.[4]

In January 1988, the Commission invoked the same asserted statutory power when it ordered COMSAT to refund to its customers the sum of $38.755 million for past periods based solely on a finding that this was the amount by which COMSAT had exceeded a previously prescribed rate of return. The FCC, relying on the holding of the court of appeals in the instant case, found it unnecessary even to discuss COMSAT's arguments that the Commission lacked the statutory power to take such action.[5]

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[4] *Authorized Rates of Return for Interstate Services of AT&T Communications and Exchange Telephone Carriers*, 50 Fed. Reg. 41,350 (1985) (subsequent FCC history omitted). The D.C. Circuit subsequently invalidated these rules on other grounds in *American Tel. & Tel. Co. v. FCC*, 836 F.2d 1386 (D.C. Cir. 1988) ("*Rulemaking Case*"), New England App. at 141a. However, two members of the panel in the *Rulemaking Case* stated that the decision from which certiorari is now sought had dispositively resolved the statutory question; one member of that panel disagreed, stating that the refund rule adopted by the Commission was inconsistent with the statutory scheme.

[5] *Communications Satellite Corp.*, 3 FCC Rcd 2643, 2645 (1988). As noted above, COMSAT has petitioned for review of that order, and the D.C. Circuit has deferred briefing pending resolution of this case. Since the release of the COMSAT rate order, there has been at least one other major rate investigation in which the FCC has ordered refunds for past periods even though the conditions of Section 204(a)—suspension of rates, investigation and imposition of an accounting order—had not been met. *See Annual 1988 Access Tariff Filings*, Memorandum Opinion and Order, FCC 88-420 (released Dec. 27, 1988). Petitions for reconsideration of that decision are now pending before the FCC, and it is noted here only

The FCC action sustained by the court below may have consequences that go beyond the scope of the Communications Act. As noted by petitioners,[6] the Communications Act was patterned on the Interstate Commerce Act, 49 U.S.C. § 10101 *et seq.*, which also was the model for the Federal Power Act, 16 U.S.C. § 791a *et seq.*, and the Natural Gas Act, 15 U.S.C. § 717 *et seq.* Each of these statutes reflects a carefully crafted scheme in which the ability of the regulatory agency retroactively to modify a carrier's charges is carefully circumscribed. Under none of these statutory schemes may the carrier or the regulatory agency design present or future rates to compensate for or redress the effect of events that took place in the past; instead, retroactive relief is limited to certain circumstances not present here. It is in this sense that Judge Starr noted that the instant case presents a "pivotal statutory issue cutting across agency lines." [7]

Ultimately what is at issue in this case is whether an agency may, through reliance on general provisions like Section 4(i) of the Communications Act, 47 U.S.C. § 154(i), rewrite a statute to confer new powers on itself. Judge Starr's concurring opinion in the *Rulemaking Case* squarely recognized the heart of the matter: "we must not permit those quasiautonomous creatures of the political branches to tear asunder that which the representatives of the people have seen fit to ordain and maintain for a quarter of the Nation's history." [8] We show below that this is precisely what the FCC has done.

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to show that the agency has continued to adhere to its expansive interpretation of its statutory authority.

[6] Southern Bell Pet. at 12, 13 & n.21, 16 n.25; New England Pet. at 3 n.1.

[7] Order denying suggestion for rehearing *en banc*, Southern Bell App. at 44a; New England App. at 135a (Starr, J., joined by Buckley and Williams, J.J., dissenting).

[8] *Rulemaking Case, supra* n.4, 836 F.2d at 1396, New England App. at 159a (Starr, J., concurring).

II.

The decision of the court of appeals is fundamentally erroneous because, as noted in the dissent to the denial of rehearing *en banc*, "the FCC has . . . purported to exercise a power which Congress never conferred upon it." [9] The retroactive refund power that the FCC now asserts certainly cannot be found in the statutory provisions, taken alone or in combination. Moreover, the agency's action is at odds with over fifty years of agency and judicial interpretation of this and analogous statutory schemes.

Congress set out in the Communications Act a regulatory regime that gives the FCC power to regulate rates but reflects the well established prohibition against retroactive ratemaking, with carefully circumscribed refund power.[10] Under Section 204(a), the FCC may suspend a carrier's new or revised tariff for a specified period and investigate its lawfulness.[11] If the FCC has not completed its investigation by the end of the suspension period, and the carrier puts the tariff into effect, the FCC may impose an accounting order requiring the carrier to keep accurate account of all amounts received from new or increased charges. Should the FCC ultimately determine that the charges exceed that which is just and reasonable, it may then order the carrier to refund the difference between the tariff filed and the charges ultimately approved.

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[9] Southern Bell App. at 44a; New England App. at 135a (Starr, J., joined by Buckley and Williams, J.J., dissenting).

[10] *See, e.g., FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 618 (1944); *Board of Pub. Util. Comm'rs v. New York Tel. Co.*, 271 U.S. 23, 31-32 (1926); *Galveston Elec. Co. v. City of Galveston*, 258 U.S. 388, 395 (1922); *American Pub. Gas Ass'n v. FPC*, 567 F.2d 1016, 1057 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978); *Washington Gas Light Co. v. Baker*, 188 F.2d 11, 21 (D.C. Cir. 1950), *cert. denied*, 340 U.S. 952 (1951).

[11] 47 U.S.C. § 204(a).

Section 205 applies to a carrier's existing tariffs. Under that section, the FCC may investigate a carrier's charges on its own motion or upon a complaint, and if it finds that they are not just and reasonable, it may "determine and prescribe what will be the just and reasonable . . . charges to be *thereafter* observed." [12] Under Section 205, the FCC cannot impose an accounting order or subsequently order refunds with respect to the investigated rates.

The statute carefully balances the interests of carriers and their customers. A carrier initiates tariff filings, but the agency has an opportunity to review the new rates before they become effective to confirm that the carrier has filed in accordance with all pertinent requirements. The agency may suspend the new rates and begin an investigation. If the investigation extends beyond the statutorily prescribed suspension period, the carrier may put the new rates into effect, but the agency has the option of imposing an accounting order to preserve its authority to order refunds should it ultimately determine that the tariffs were not valid when filed.

Rates that go into effect without an accounting order are the only amounts that the carrier may charge and its customers must pay, with no provision for refunds or retroactive increased charges. If the carrier believes that its existing rates are producing unreasonably low earnings, it may file higher rates that are subject to the Section 204 review authority. On the other hand, if the agency, after a Section 205 investigation, determines that a carrier's existing rates are unreasonably high, it may order the carrier to lower its rates to a level then deemed reasonable. But rate changes, whether proposed by a carrier or ordered by the FCC, can only be effective on a prospective basis.

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[12] 47 U.S.C. § 205(a) (emphasis added).

The court below fails to apply the statutory provisions mandated by Congress. Basing its decision upon its expansive interpretation of the court of appeals' earlier opinion in *Nader v. Federal Communications Commission*, 520 F.2d 182 (D.C. Cir. 1975), the court reasons that if the FCC has the power to prescribe a rate of return—as *Nader* held—then it must have the power to enforce that prescription retroactively through a refund order.

The court below misreads *Nader*. The *Nader* court ruled only that the FCC could properly determine AT&T's allowed rate of return and authorize AT&T to use that rate of return in filing its rates, while the agency continued its investigation into AT&T's rate base and the other elements that go into the ratemaking process.[13] *Nader* did not purport to change the FCC's basic method of ratemaking, nor bestow any special significance on a rate of return prescription. In particular, *Nader* did not hold that a prescribed rate of return has the attributes of a prescribed rate under Section 205 of the Act; to the contrary, it explicitly stated that the "claim that a rate of return is equivalent to rates must be rejected since a rate of return is merely one component of a rate." [14]

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[13] In particular, the court stated:

> Obviously, reaching a decision on each of the components that make up a rate is a time-consuming task, especially when the Commission undertakes to reevaluate the economic principles for making these determinations. If the Commission can effectuate its decision as it adjudicates each component of the rate, the public more rapidly receives the benefit of the protection inherent in the Commission's authorization to prescribe just and reasonable charges. Therefore, we believe that the Commission's Phase I order prescribing AT&T's rate of return was in the public interest . . . .

520 F.2d at 204.

[14] *Id.* at 201. When a rate of return is prescribed, the carrier must file rates designed to achieve that return, and the FCC will scrutinize those rates to determine whether the projections are reasonable. But as New England Telephone petitioners show (Pet.

Nor did *Nader* "bring[] with it an enforcement mechanism" that authorizes the FCC to set future rates to compensate for past events;[15] again to the contrary, *Nader* reaffirmed "the cardinal principle" barring retroactive ratemaking[16]—namely, that neither a utility nor an agency may set rates to recoup past losses or refund past surpluses.

The court below recognizes that Section 205 by its terms does not confer the refund authority claimed by the FCC. However, it puts Section 205 together with Section 4(i) of the Act—which confers on the FCC a general power to perform any and all acts and make rules and regulations "not inconsistent" with the Act "as may be necessary in the execution of its functions"[17]—to uphold the refund order. The court's rationale is that since the FCC can prescribe a rate of return under Section 205, Section 4(i) authorizes it to enforce that prescrip-

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at 11), no one can be sure that the return achieved will equal or be greater or less than the prescribed return no matter how meticulous the carrier's projections. That is so because when carriers are calculating their rates, they of necessity must forecast future traffic levels along with projected costs and revenues. If the actual demand, costs and revenues are (for whatever reason) different from the estimates—which, given the inherent imprecision of estimates, will almost always be the case—the carrier's actual return will differ from the allowed rate of return upon which the carrier's tariffs were based. *See, e.g., American Tel. & Tel. Co.*, 42 F.C.C.2d 293, 300 (1973). Given that a rate of return prescription is by its nature therefore simply a prescribed goal, there is no more justification for retroactive refunds with respect to a rate filed in response to a rate of return prescription order than for such refunds with respect to an ordinary rate filing—a power the Commission does not claim to possess. Rather, the issue with respect to rate of return is the same as that for the other components of the charge —namely, whether the forecasts were reasonable when made.

[15] *Rulemaking Case, supra* n.4, 836 F.2d at 1395, New England App. at 156a (Starr, J., concurring) (emphasis in original omitted).

[16] *Nader*, 520 F.2d at 202.

[17] 47 U.S.C. § 154(i).

tion essentially by any means it chooses, including a refund order.

This reasoning is fallacious in two respects. First, a rate of return prescription is not a prescription order within the meaning of Section 205. Section 205(a) empowers the FCC to prescribe "the just and reasonable . . . *charge* or *charges* to be thereafter observed." [18] When the FCC prescribes a carrier's charge, it specifies an amount, and both the carrier and its customers know that is the amount that the carrier is to charge and the customer is to pay, and neither expects (nor can obtain) any adjustments.[19] In contrast, when the FCC prescribes a rate of return, the carrier uses that rate of return in calculating its rates, but neither it nor its customers will know whether it has achieved (or exceeded) that rate of return until after the fact. And, as has been discussed elsewhere,[20] if the carrier is to be held to its prescribed rate of return retroactively, it will virtually always be recouping shortfalls or refunding surpluses, thereby effectively eliminating the prospectivity of Section 205 from the Act.

Second, Section 4(i) cannot be used to circumvent the specific substantive provisions of the Act.[21] The specific

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[18] 47 U.S.C. § 205(a) (emphasis added).

[19] *See, e.g., Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Ry. Co.*, 284 U.S. 370, 389-90 (1932).

[20] *See supra* n.14.

[21] *See Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 370 (1986) ("we would be disinclined to favor the provision declaring a general statutory purpose, as opposed to the provision which defines the jurisdictional reach of the agency formed to implement that purpose"); *MCI Telecommunications Corp. v. FCC*, 765 F.2d 1186, 1194 (D.C. Cir. 1985) (Commission's authority cannot be released "from the tie that binds it to the text [of Title II] Congress enacted"); *MCI Telecommunications Corp. v. FCC*, 561 F.2d 365, 375 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1040 (1978);

provisions of the Communications Act discussed above reflect a deliberate decision by Congress that, except as specified in Section 204(a), which is not relevant here, ratemaking is to be prospective. Adherence to that principle is both balanced and fair: since a carrier cannot go back to its customers to make up any shortfalls, it should not have to pay them any amounts that are determined after the fact to be surpluses. It also preserves incentives for a carrier to economize: if the carrier's costs exceed its estimates, it cannot seek reimbursement from its customers, whereas if it is able to realize efficiencies, it can benefit from them at least for the period of regulatory lag. Finally, as noted by Judge Starr in his concurrence in the *Rulemaking Case*, a scheme in which carriers are required to make refunds for past surpluses "does clear violence to the values of stability and predictability that Congress so carefully enshrined in the Communications Act." [22]

In sum, an agency must follow its governing statutory scheme, remaining faithful to both its terms and intent. The court below improperly sanctions the use of the general provisions of Section 4(i) in a fashion that disrupts that scheme. Moreover, the court's decision is clearly contrary to a host of other decisions interpreting the Communications Act and related statutes applicable to other

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American Tel. & Tel. Co. v. FCC, 487 F.2d 865, 876-80 (2d Cir. 1973). *See also Public Serv. Comm'n v. FERC*, No. 87-1706, slip op. at 9-10 (D.C. Cir. Jan. 27, 1989) (" 'Section 16 [of the Natural Gas Act, the equivalent of Section 4(i) of the Communications Act], which uses a broad generality of "necessary or appropriate" that is not rooted in a function, cannot enlarge the choice of permissible procedures beyond those that may fairly be implied from the substantive sections and the functions there defined.' ") (quoting with approval *Mobil Oil Corp. v. FPC*, 483 F.2d 1238, 1257 (D.C. Cir. 1973)).

[22] *Rulemaking Case, supra* n.4, 836 F.2d at 1394, New England App. at 155a (Starr, J., concurring).

industries.[23] Such action clearly warrants exercise by this Court of its certiorari jurisdiction.

CONCLUSION

For the foregoing reasons, the petitions for a writ of certiorari should be granted.

Respectfully submitted,

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[23] Petitioners have cited many decisions from both this Court and various courts of appeals that affirm the basic tenet that current and future ratemaking should not become embroiled in making corrections "'for excess or insufficiencies of rates charged in the past.'" Southern Bell Pet. at 9; New England Pet. at 14 (quoting *American Pub. Gas Ass'n v. FPC*, 567 F.2d at 1057). *See, e.g., Atlantic Refining Co. v. Public Serv. Comm'n*, 360 U.S. 378, 389 (1959); *Sea Robin Pipeline Co. v. FERC*, 795 F.2d 182, 184 (D.C. Cir. 1986); *Electrical Dist. No. 1 v. FERC*, 774 F.2d 490, 492 (D.C. Cir. 1985); *Indiana & Michigan Elec. Co. v. FPC*, 502 F.2d 336, 345 (D.C. Cir. 1974), *cert. denied*, 420 U.S. 946 (1975). *See also Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 578 (1981); *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348, 353 (1956). We do not repeat that discussion here, other than to emphasize that all of these cases are grounded upon a faithful reading of the applicable statutes, each of which parallels the Communications Act.